

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

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	:	
In re	:	Chapter 11
	:	
PINNACLE AIRLINES CORP., <i>et al.</i>,	:	Case No. 12-11343 (REG)
	:	
Debtors.	:	(Jointly Administered)
	:	
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**DECLARATION OF DANIEL M. KASPER
IN SUPPORT OF MOTION TO REJECT COLLECTIVE BARGAINING
AGREEMENTS WITH THE AIR LINE PILOTS ASSOCIATION, INTERNATIONAL,
AND THE ASSOCIATION OF FLIGHT ATTENDANTS-CWA, PURSUANT TO 11
U.S.C. § 1113**

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I, DANIEL M. KASPER, subject to the penalties provided by law for perjury, do hereby declare the following to be true and correct:

I. QUALIFICATIONS & ASSIGNMENT

1. I am a Senior Consultant for Compass Lexecon. I have over 30 years of consulting experience at Compass Lexecon, LECG, Coopers & Lybrand, L.L.P., and Harbridge House, Inc. My work has dealt extensively with issues involving economics, finance, competition and competition policy in the airline and aerospace industries. I have also served for a total of ten years on the faculties of the Harvard Business School and the University of Southern California School of Business Administration.
2. Between 1979 and 1983, I served at the United States Civil Aeronautics Board (“CAB”), first advising the Vice-Chair of the Board on all matters pending before the agency and then as the Director of International Aviation. In the latter capacity, I was the Board’s primary advisor and chief line officer for all matters involving international aviation.
3. In 1993, I was one of 15 members of the *National Commission to Ensure a Strong and Competitive Airline Industry*, a body created by Congress and appointed by the President and the Congressional leadership to evaluate and make recommendations on how to improve the performance of the U.S. airline and aerospace industries. In addition, I have served as a consultant to the U.S. Departments of Transportation, State and Defense on various aviation industry matters, and have also testified as an expert on airline and aviation industry matters before courts and federal administrative agencies, as well as legislative bodies and antitrust authorities both in the United States and abroad. I earned my M.B.A. and J.D. degrees from the University of Chicago. My *curriculum vitae* is attached to this declaration as Appendix A.

4. I have been retained by Pinnacle Airlines Corporation (“Pinnacle” or “the Company”) and asked to evaluate—based on my knowledge, experience and understanding of the airline industry, airline economics and competition—the current state of the U.S. airline industry generally, and the U.S. regional airline industry in particular. I have also been asked to evaluate Pinnacle’s current and prospective competitive position in the regional airline industry. I submit this declaration in support of Pinnacle’s *Motion to Reject Collective Bargaining Agreements With the Air Line Pilots Association, International, and the Association of Flight Attendants-CWA, Pursuant to 11 U.S.C. § 1113*.
5. This declaration contains my opinions as well as the bases for those opinions. In preparing this analysis, I have been assisted by economists on the staff of Compass Lexecon. The opinions set forth in this declaration are based upon my review and analysis of: (i) relevant articles, academic publications and publicly available information and data sources routinely relied upon by economists and other airline industry analysts including the Official Airline Guide (“OAG”) schedule database, the U.S. Department of Transportation’s (“DOT”) Survey of Origin and Destination passengers (“DB1B”), Form 41¹ and flight segment (“T-100”) databases, airline annual reports and other filings made with the U.S. Securities and Exchange Commission (“SEC”), press releases, as well as airline and financial trade press sources; (ii) conversations with and information provided by Company officials; (iii) declarations, pleadings and other documents that have been filed as part of Pinnacle’s restructuring to date; and (iv) my own knowledge and more than

¹ Throughout this Declaration I rely on a number of sources for costs including the U.S. DOT Form 41 Database. The Form 41 database compiles the financial and traffic data required by federal regulations to be submitted to the U.S. government, following the guidelines in the U.S. CFR Part 241, “Uniform System of Accounts and Reports for Large Certificated Air Carriers.” While I also used data from the carriers’ SEC filings where available, the Form 41 data typically contains far greater detail than is available in SEC filings, is subject to a uniform set of filing rules across carriers, and is subject to regulatory rules and review by the U.S. DOT. Form 41 data are routinely used in regulatory and judicial venues in the U.S., including the Chapter 11 restructurings of American, United, Delta, Northwest and US Airways, as well as regional carriers American Eagle, Comair and Mesaba.

30 years of experience from working with, researching and/or regulating the airline and aerospace industries.² My investigation and consideration of the issues in this matter is ongoing. Accordingly, my opinions are subject to revision based on the work I may complete in the future and further documents, data, testimony, and other materials I may review. If called as a witness, I could and would testify competently to the opinions set forth in this declaration. My professional fees for this matter are \$725 per hour.

II. SUMMARY OF OPINIONS

6. Based on my analysis of the issues to date, I have formed the following opinions.

(i) **Pinnacle's Large Network Carrier Customers Face Relentless Pressure to Control Their Costs**

7. Pinnacle's customers, the large network carriers that have included Delta, Northwest, United, Continental and US Airways, face relentless pressure to control their costs. The need for the large network carriers to control their costs stems from several factors, the most important of which are: (i) the rapid growth and geographic expansion of low cost carriers ("LCCs")³; (ii) increased price

² A list of documents and information sources considered is included as Appendix B.

³ Throughout this Declaration, I use the term "large network carriers" to refer to American, Delta (recently merged with Northwest), United (recently merged with Continental) and US Airways. These carriers are the surviving set of large carriers, most of which were established long before deregulation, that operate on a "hub and spoke" traffic model, service a wide variety of both domestic and international destinations using multiple aircraft types, and have workforces relatively more senior than the newer entrants. I use the term "LCC" to refer to the category of generally lower-cost air carriers that have emerged since the Airline Deregulation Act of 1978 and transformed the industry from an environment of economic regulation to one of intense price competition. In recent years this phenomenon has not only taken hold but (in the era of price transparency brought on by the proliferation of Internet fare advertising and booking) has flourished, and is typified by the success of carriers such as Southwest, JetBlue, Spirit, and Allegiant. Most (but not all) of the LCCs' operating models make use of point-to-point services, and utilize a simplified fleet of one or two types of narrowbody aircraft, lower average fares, more flexible work rules, quick turn-around times and (because of their relatively recent vintage) an employee population of lesser seniority than the large network carriers. Although the largest LCC, Southwest Airlines, began offering interstate domestic

transparency resulting from the Internet; (iii) high fuel prices that have made many routes unprofitable; and (iv) changes in security screening following September 11th, 2001, that have depressed the demand for short-haul travel by air.

a. Low Cost Carriers Have Put Downward Pressure on Large Network Carrier Prices

8. Perhaps the single largest factor impacting the large network carriers' need to control their costs—including their costs for regional carrier lift (i.e., flying services)⁴—has been the dramatic growth and widespread passenger acceptance of LCCs. Because of their substantially lower cost structures, LCCs are able to operate profitably at average fares far below those of the large network carriers. Consequently, the expansion and widespread passenger acceptance of LCCs has placed dramatic downward pressure on the fares charged by the large network carriers.⁵ As a result, LCCs have increased their share of domestic origin and

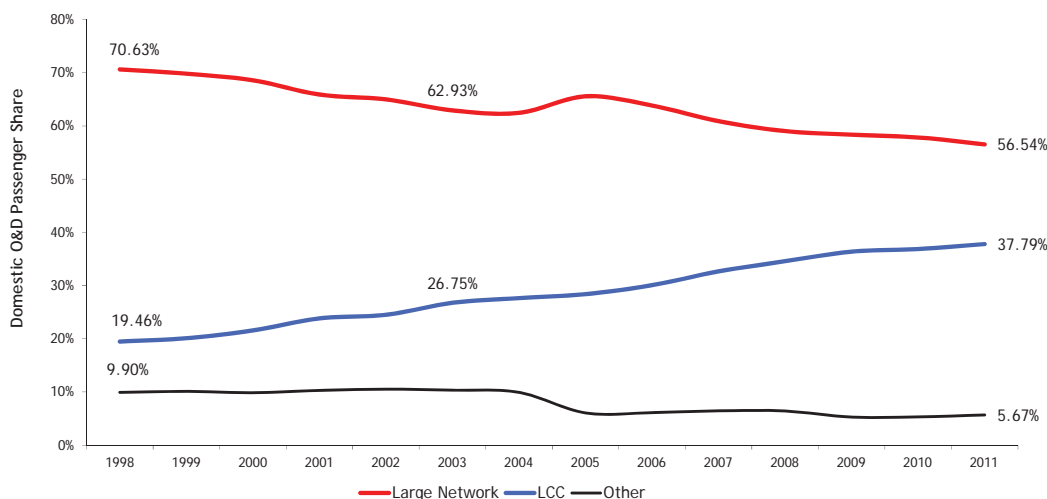
services shortly after the airline industry was deregulated in 1978, many of the other LCCs such as JetBlue, Spirit, Virgin America and Allegiant only began offering scheduled services in the 1990s or later.

⁴ As described in detail in Section III of this report, the large network carriers rely on regional carriers—i.e., those carriers that operate relatively smaller turboprop and regional jet aircraft (typically with seating capacities ranging from 19 to 90 seats)—to provide lift on routes (or at times of the day) where passenger demand is insufficient to economically deploy a larger, mainline aircraft. Mainline aircraft are the large jet aircraft, typically with 90 or more seats principally manufactured by Boeing (e.g., the B-737, B-757, B-767, B-777 etc.), Airbus (e.g., the A-319, A-320, A-330, etc.) and formerly McDonald Douglas (e.g., the MD-80, MD-88, etc.) that are operated by the large network carriers and LCCs. Regional aircraft are relatively smaller (i.e., less than 90 seat) turbo-prop or jet aircraft principally manufactured by Bombardier (e.g., the CRJ-200, CRJ-700, CRJ-900, CRJ-1000, Q-400 etc.) and Embraer (e.g., the ERJ-135, ERJ-145, E-170, E-175 etc.). Other smaller manufacturers of regional aircraft currently in use in the U.S. include ATR and Saab. Mitsubishi Aircraft Corporation also expects to launch a new series of 70-90 seat RJs in mid-2015 and has received orders from SkyWest and Trans States. See “Mitsubishi Regional Jet Schedule Update,” Mitsubishi Aircraft News No. 21, April 25, 2012, “Mitsubishi Aircraft and SkyWest, Inc. Announce 100 Aircraft Agreement in Principle,” Mitsubishi Aircraft Corporation press release, July 11, 2012 and “Trans States Holdings Signs LOI with Mitsubishi Aircraft for Purchase of 100 MRJ Aircraft,” Mitsubishi Aircraft News No. 10, October 2, 2009.

⁵ While LCC service for many years was largely synonymous with Southwest, today there are number of other well-capitalized LCCs such as JetBlue, Allegiant, Spirit and Virgin America that have gained widespread passenger acceptance by (among other things) establishing reputations as safe and reliable carriers, taking deliveries of large numbers of new and modern jet aircraft and (in the case of JetBlue and Virgin America) offering a novel array of in-flight amenities. For example, the *Airline Quality Rating 2012* conducted by Wichita State University and the Purdue University ranked many LCCs above the large

destinations (“O&D”)⁶ passengers dramatically, largely at the expense of the large network carriers.

EXHIBIT 1: LARGE NETWORK CARRIERS’ DECLINING SHARE OF DOMESTIC O&D PASSENGERS, 1998-2011



Source: U.S. DOT DB1B

Note: Share of domestic O&D passengers. Large Network carriers include American, TWA, Continental, Delta, Northwest, United, and US Airways (with America West after 2005). LCCs include ATA, Access Air, AirTran, Allegiant, Eastwind, Frontier (including Midwest from 2009), JetBlue, Independence Air, Kiwi, Midway, National, Pro Air, Reno, SkyBus, Southwest, Spirit, Sun Country, Vanguard, Virgin America, and Western Pacific. Other includes Alaska, Hawaii, Aloha, Midwest, and other smaller carriers.

9. Moreover, the impact of LCCs on large network carrier pricing is far greater than is suggested by the LCCs’ O&D market share in Exhibit 1. This is due to the fact that the simple availability of LCC service on a city-pair exerts downward pricing pressure on the fares that the large network carriers can charge.⁷ And, as

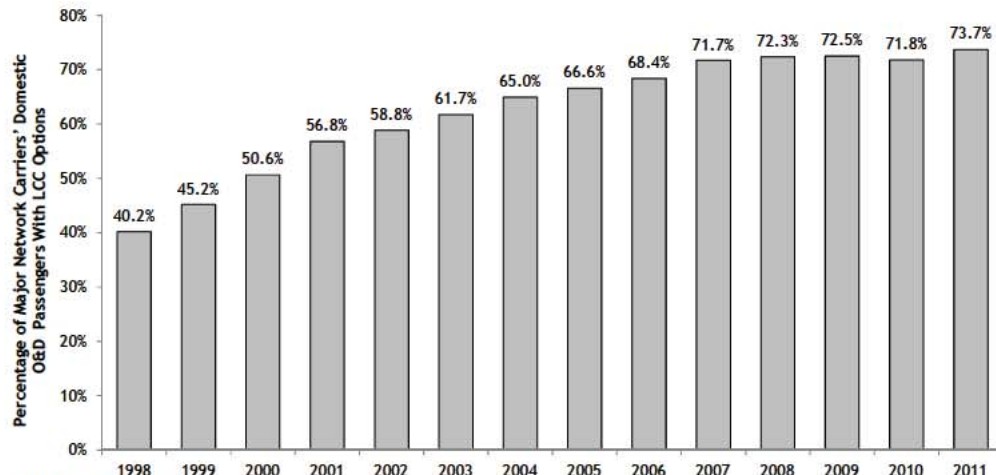
network carriers in 2011: AirTran (#1), Hawaiian (#2), JetBlue (#3), Frontier (#4), Alaska (#5), Delta (#6), Southwest (#7), US Airways (#8), SkyWest (#9), American (#10), Continental (#11), United (#12). See <http://downloads.airlinequalityrating.com/reports/2012agr.pdf>. Virgin America, Spirit, and Allegiant were not included in the 2012 study. As noted below in Exhibit 11, SkyWest is the largest regional carrier and operates flights on behalf of United, Delta, Alaska and US Airways.

⁶ O&D (“origin and destination”) passengers are counted based on the starting and ending point of their journey, regardless of whether or not they make a connection. For example, a passenger traveling from New York City to Los Angeles making a connection in Atlanta is counted as a single O&D passenger.

⁷ See, for example, “Fare Restructuring in Cincinnati – Second Quarter 2005,” Office of Aviation and International Affairs, Aviation Analysis, Domestic Aviation Competition Issue Brief Number 28, noting that “When presented with a viable, less expensive alternative, comparatively few consumers are willing to pay the high fares that they are forced to pay absent the availability of an alternative. The legacy carriers

demonstrated by Exhibit 2, nearly three quarters of large network carriers' domestic O&D passengers in 2011 traveled on city-pairs with LCC options (defined as city-pairs with at least one LCC with at least a 5% share).⁸

EXHIBIT 2: PERCENTAGE OF LARGE NETWORK CARRIERS' DOMESTIC O&D PASSENGERS WITH LCC OPTIONS, 1998- 2011



Source: U.S. DOT O&D DB18

Notes: Major Network Carriers include United, Continental, American, Delta, Northwest, US Airways, America West, and TWA. Southwest includes AirTran in 2011. Percentage of Major Network Carriers' domestic O&D passengers on city-pairs where at least one LCC has at least a 5% O&D passenger share. Airports in the following domestic metropolitan areas are grouped: Chicago (ORD, MDW), Cincinnati (CVG, DAY), Cleveland (CLE, CAK), Dallas (DFW, DAL), Houston (HOU, IAH), Los Angeles (LAX, BUR, LGB), Miami (MIA, FLL), New York (LGA, JFK, EWR), San Francisco (SFO, OAK), Washington DC (DCA, IAD, BWI), Phoenix (PHX, AZA), and Tampa (TPA, PIE). LCCs include Southwest, JetBlue, AirTran, Frontier (including Midwest from 2009), Spirit, Sun Country, ATA, Allegiant, National, Vanguard, Access Air, Eastwind, Pro Air, Reno, Air South, Virgin America, and Midway.

10. Although LCCs now impact pricing on city-pairs accounting for the vast majority of domestic O&D passengers, their influence on the large network carriers' prices and revenues is likely to increase even more in the future. LCCs currently have

are thus usually forced to adopt a pricing and yield management posture similar to that of their low-cost carrier competition. However, unlike the low-cost carriers, the legacy carriers do not have the cost structure to support the seismic shift in the revenue environment that occurs concomitant with low-cost carrier entry."

⁸ The transformational impact that LCCs were starting to have on the large network carriers by the early part of this century was not lost on labor. For example, as noted by the then head of the Air Line Pilots Association (the country's largest pilots union), LCCs had reached a competitive "tipping point" by late 2002: "Ten years ago, except for Southwest in Texas, Arizona, and California, low cost carriers were only a nuisance in most of the country; now they are a major force and at least three of them are well financed with strong balance sheets... [They] now pose a serious threat to network carriers and their futures." See *Report of Captain Duane Woerth to the 90th Executive Board of ALPA*, September 10-13, 2002.

large orders booked for new aircraft to support continued domestic expansion,⁹ and over the past several years LCCs have also begun to rapidly enter international markets. For example, JetBlue has increased the number of routes to/from the Caribbean/Latin America from 11 to 38 between 2007 and 2011¹⁰ and overall, the number of routes between the United States and the Caribbean/Latin America served by LCCs grew from only 18 in 2003 to 129 today.¹¹

b. Price Transparency Resulting from Internet Search and Booking Engines Has Put Further Downward Pressure on Airfares

11. In addition to intense competition from LCCs, other factors such as Internet-based airline search and booking tools have also put downward pressure on airfares by increasing price transparency for both business and leisure passengers.¹² The rapid spread of Internet-based airfare search engines has greatly reduced (indeed, almost eliminated) the costs of searching for the lowest possible fares and thus greatly increased consumers' ability to find and purchase the lowest available fares.

⁹ For example, Southwest Airlines, the world's largest LCC, has firm orders for 197 new aircraft for delivery by 2017. Likewise, Virgin America recently placed firm orders for 60 new aircraft to be delivered starting in 2013 that will triple the size of its current fleet. Moreover, Spirit Airlines recently announced an order for 75 additional Airbus A320 aircraft to be delivered between 2016 and 2021, bringing Spirit's total new aircraft orders to 103. Similarly, JetBlue has 93 new aircraft on order and scheduled for delivery between 2012 and 2018. See Southwest SEC 10-Q 2012 Quarter 1; "Virgin America Places Airbus's 10,000th Order: Signs Firm Order For 60 New Aircraft, Including First Order For Eco-Efficient A320neo: Airline Triples Fleet Size with 60 Planes and Celebrates with a 'Sweet 60' Fare Sale," Virgin America Press Release, January 17, 2011; "Spirit Airlines Signs Memo of Understanding for 75 Airbus Aircraft," Spirit Airlines Press Release, November 15, 2011; Spirit Airlines SEC 10-Q 2012 Quarter 1; and JetBlue SEC 10-Q 2012 Quarter 1.

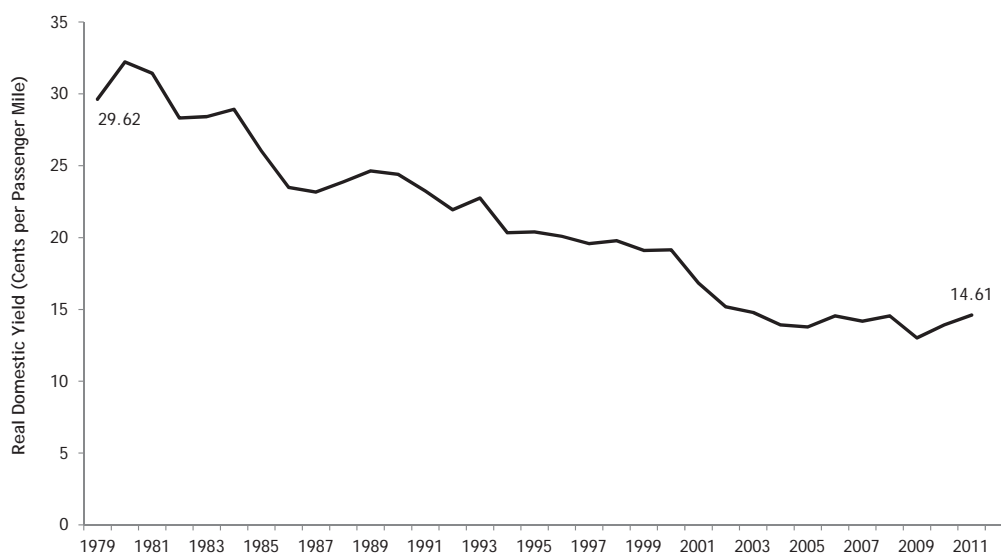
¹⁰ Source: OAG. For the purposes of this declaration, I say that a carrier "serves" an international route if in any month of the given year the carrier had at least eight round trip departures on that route.

¹¹ Source: OAG. Moreover, Southwest, the largest U.S. LCC, has announced that it will commence international services from Houston starting in 2015. See "Domestic giant Southwest sticks nose into international air", *USA Today*, May 23, 2012.

¹² For example, approximately 54% of travel (the largest component of which is airline tickets) was purchased online in 2010, up from only 20% in 2003. See "Online Growth Steady for Both Suppliers and Online Travel Agencies," PhoCusWright, July 7, 2004, http://www.phocuswright.com/research_updates/online-growth-steady-for-both-suppliers-and-online-travel-agencies and Orbitz Worldwide Investor Presentation, August 9, 2011.

12. The combined effect of LCC growth and the ability of passengers to easily compare fares across all carriers and thereby find the lowest available price has been a long-term secular decline in airfares. As demonstrated by Exhibit 3, for example, from 1979 to 2011 the average price per mile (known in the industry as “yield”) for air service has decreased by over 50% in “real” (i.e., inflation adjusted) terms.¹³

EXHIBIT 3: REAL DOMESTIC PRICE (YIELD), 1979-2011



Sources: Airlines For America; U.S. BLS

Notes: 2011 Dollars. Fares exclude excise taxes and passenger facility charges

c. High Fuel Prices Have Forced Large Network Carriers to Reduce Capacity

13. In addition to expanded competition from LCCs, the sharp rise in the price of jet fuel has further undercut the ability of large network carriers to cover their costs in a growing number of markets. As a result, network carriers have been forced to

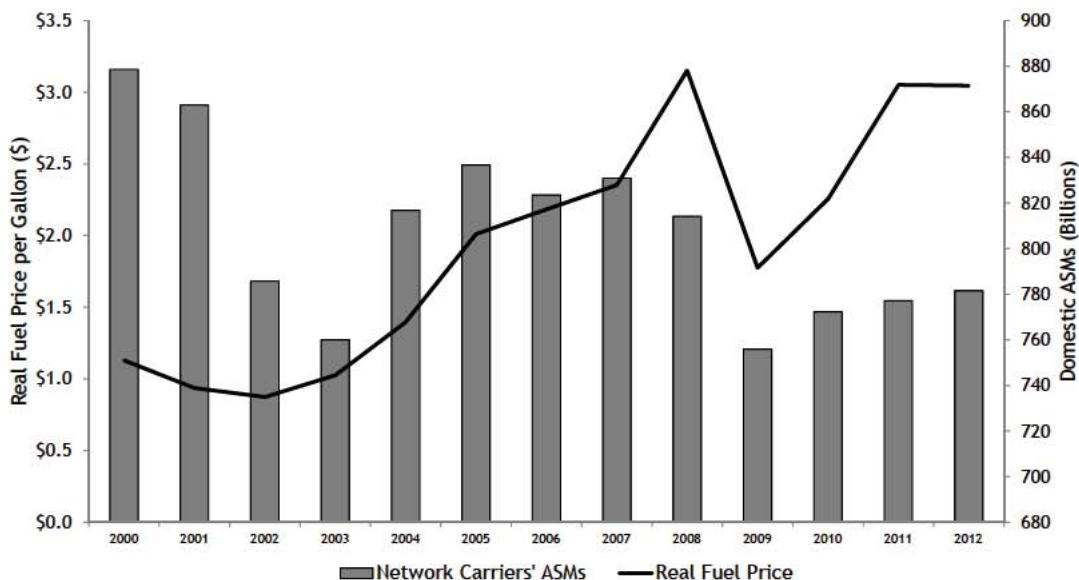
¹³ Throughout this Declaration I use the term “real” to describe historical prices that have been converted to current price levels using the consumer price index (“CPI”) from the U.S. Bureau of Labor Statistics.

eliminate services that can no longer be provided economically at prevailing fuel prices. The economic force driving the industry-wide capacity reductions as responses to the high fuel prices over the past several years has been the strong negative response of demand for air services to price increases (i.e., demand for air services is “price elastic”).¹⁴ Because carriers cannot fully absorb the burden of higher fuel prices, they must attempt to pass along part of the higher price of jet fuel to passengers in the form of higher fares. However, when carriers raise prices to offset the higher cost of jet fuel, passenger demand wanes (in turn reducing revenues) forcing large network carriers to reduce capacity to match the new level of demand. As demonstrated by Exhibit 4, since 2000 the large network carriers have reduced their domestic capacity (as measured by available seat miles) by more than 10%.¹⁵

¹⁴ See “Air Travel Demand Elasticities: Concepts, Issues and Measurement,” by David Gillen, William Morrison and Christopher Stewart, in Darin Lee, ed., *Advances in Airline Economics*, Volume 2, pp. 365-410. Amsterdam: Elsevier, 2007.

¹⁵ An available seat mile (“ASM”) is a standard industry measure of capacity that represents one seat flown one mile. ASMs are calculated by multiplying the number of seats on a flight by the distance flown and are a standard measure of airline capacity or size. Thus, a 50-seat aircraft flown 500 miles generates 25,000 ASMs.

EXHIBIT 4: HIGH FUEL PRICES HAVE CONTRIBUTED TO REDUCTIONS IN LARGE NETWORK CARRIERS' DOMESTIC CAPACITY



Sources: OAG, U.S. EIA; CPI from U.S. BLS.
Notes: 2012 fuel prices are through Aug. 13, 2012. 2012 dollars. Fuel is U.S. Gulf Coast Kerosene-Type Jet Fuel Spot Price FOB (Dollars per Gallon). Large network carriers include: United, American, Delta, Northwest, Continental, US Airways, Northwest, America West and TWA.

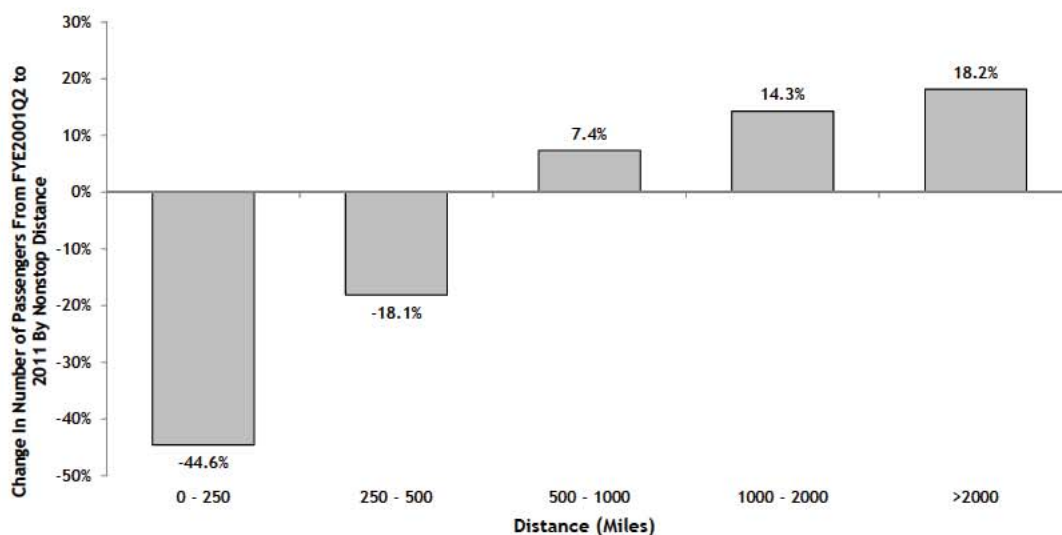
d. Demand for Short-Haul Traffic Has Been Dramatically Reduced as A Result of Post-September 11th Security Changes

14. Finally, the demand for airline service has also been diminished by the more onerous passenger screening procedures that followed in the wake of the September 11th terrorist attacks (often referred to as the “hassle factor”) that made traveling by air more time consuming and less convenient, further reducing passenger demand, particularly in short-haul markets which account for the bulk of regional carrier flying.¹⁶ Exhibit 5 shows that while the number of passengers traveling more than 500 miles for 2011 increased relative to the year ending June 30, 2001 (i.e., the last four quarters prior to September 11, 2001), the number of

¹⁶ One published study from 2005 found that in addition to a negative transitory demand shock to U.S. domestic passenger of over 30%, the September 11th terrorist attacks also resulted in non-transitory reduction in demand of 7.4% well after the attacks which the authors attributed to the hassle factor and an increased fear of flying. See “Assessing the Impact of the September 11 Terrorist Attacks on U.S. Airline Demand,” Harumi Ito and Darin Lee, *Journal of Economics and Business*, Volume 57 (2005), pp. 75-95.

passengers traveling less than 250 miles has dropped by nearly 45% compared to pre-September 11th levels. Overall, traffic on routes of 250-500 miles has dropped by more than 18%. In aggregate, the reduction in short-haul demand (where regional aircraft are most commonly deployed) has resulted in the loss of approximately 30 million annual O&D passengers.¹⁷

**EXHIBIT 5: PERCENTAGE CHANGE IN DOMESTIC O&D PASSENGERS, 2011 vs. YEAR
ENDING JUNE 30, 2001**



Source: U.S. DOT O&D DB1B FYE2001Q2 and 2011
Note: Domestic

15. In sum, the harsh competitive environment, combined with a dramatic increase in jet fuel prices and a variety of other external industry shocks (September 11th, wars in Iraq and Afghanistan, SARS, hurricane Katrina, etc.) have contributed to over \$30 billion in operating losses incurred by large network carriers since 2001.¹⁸ Moreover, these unsustainable losses ultimately forced all of the surviving large

¹⁷ In July 2012, 65% of regional carrier flights were 500 miles or less. *Source*: OAG.

¹⁸ *Source*: U.S. DOT Form 41 Database.

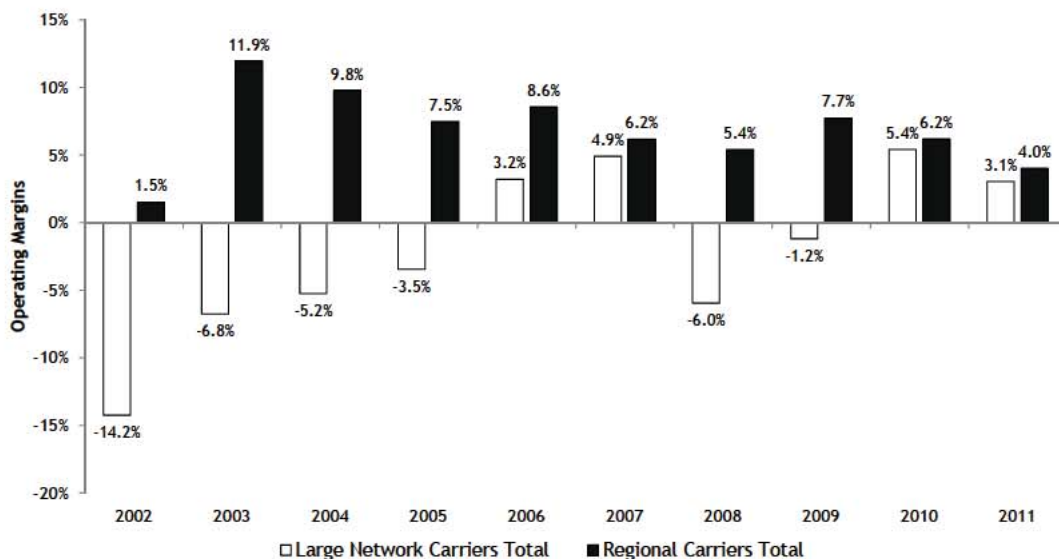
network carriers (American, United, Delta and US Airways) to restructure in bankruptcy under Chapter 11 and seek to reduce all of their controllable costs, including the costs for regional carrier lift.

(ii) Regional Airlines Now Face Similar Challenges

16. Although the changes described above exacted a dramatic toll on the large network carriers, until recently regional carriers—as a group—have fared much better than the large network carriers. This difference in financial performance between regional and large network carriers was largely due to the fact that most capacity purchase agreements (“CPAs”) between large network carriers and their regional partners largely insulated regional carriers from both demand risk and the risks associated with rising fuel prices during the life of the contract.¹⁹ Thus, as demonstrated by Exhibit 6, the regional carriers continued to earn healthy operating profits for several years after 2001, notwithstanding the substantial losses incurred by their mainline partners.

¹⁹ As described in more detail in Section III below, under a typical capacity purchase agreement between a regional carrier and its mainline partner, fuel is a pass-through (i.e., fully reimbursed) expense for the regional carrier. Likewise, the regional carrier receives the same compensation from the mainline partner regardless of how many passengers are carried on its flights, or the fares those passengers pay.

EXHIBIT 6: OPERATING MARGINS OF LARGE NETWORK VS. REGIONAL CARRIERS, 2002-2011



Sources U S DOT Form 41

Notes Large Network Carriers include American, United, Continental, Delta, Northwest, US Airways (including America West for all years), and TWA Regional Carriers include SkyWest, Air Wisconsin, Mesa Airlines, AMR Eagle, PSA/Piedmont, ExpressJet, ASA, Freedom, Pinnacle, Mesaba, Colgan, Republic, Shuttle America, Trans States, Compass Airlines and GoJet

17. The restructuring of the large network carriers under Chapter 11 has led to substantial changes in the market for regional air services and in the relationships between regional and mainline carriers. In particular, Chapter 11 allowed large network carriers to reject and/or renegotiate regional carrier contracts at lower rates.²⁰ In addition, large network carriers have used bankruptcy to reject leases or otherwise reduce significantly the number of smaller and/or less efficient regional aircraft (including those operated by independent regional carriers).²¹ As noted by one industry analyst: *“Those feeder contracts used to be lucrative, with the majors*

²⁰ See, for example, Republic Airways Holding Q1-2012 Earnings Conference call (Bryan Bedford, CEO): “We’ve seen every legacy airline in the country go through one or more bankruptcy processes. And every time an airline went through it, they used the leverage of the court to come in and take bits and pieces of the contracts away from us, which when we negotiated them, gave us the decision to invest capital.” See also “Delta Could Detail Regional Framework In Mid-October,” *Aviation Daily*, August 23, 2006.

²¹ See, for example, “Boeing Sees Regional Jet Market Declining In North America,” *Dow Jones Business News*, September 2, 2010, “Reign Over,” *Airline Business*, March 26, 2010 and “Regional Airlines Get Wings Clipped by Big Partners — Shakeout Is Likely as Commuter Lines Contend With Lower Fees and Fewer Routes Amid Overall Industry Downturn,” *The Wall Street Journal*, December 30, 2009.

assuming most of the risk while providing nearly double-digit margins for a slew of regional companies. Indeed, these contracts were so healthy that regional airlines at times came to the financial aid of those same majors. But those days are long gone, as mainline operators rein in costs, restructure the loosely written capacity purchase agreements and stringently enforce every condition of the new contracts. The effect of these changes has been devastating” [italics added].²²

18. Moreover, a series of mergers between large network carriers over the past decade (i.e., Delta/Northwest, United/Continental, American/TWA and US Airways/America West) has reduced the number of large network carriers, and, hence, the number of customers for regional carrier services.
19. Finally, notwithstanding the fact that fuel is typically a “pass through” cost for regional carriers under a CPA, rising jet fuel prices have made regional jet (“RJ”) aircraft relatively less cost-effective. Thus, as fuel prices escalated, the demand for certain regional aircraft (in particular, those with smaller seating capacity) began to wane, placing tremendous pressure on the regional carriers. This is particularly true for the 50-seat (and smaller) RJs which make up the backbone of the U.S. regional carrier fleet generally, and of Pinnacle’s fleet in particular. As a result, since 2005 the large network carriers have reduced the number of 50-seat RJ block hours flown by their regional partners by 24%.²³ Moreover, Delta has recently announced it will *further* reduce the number of 50-seat RJs in its regional carrier

²² See “Collapse of The U.S. Regional Airline Industry is a Real Concern”, Aviation Week Blog, February 14, 2012. <http://www.aviationweek.com/Blogs.aspx?plckBlogId=Blog:7a78f54e-b3dd-4fa6-ae6e-dff2ffd7bdbb&plckController=Blog&plckBlogPage=BlogViewPost&newspaperUserId=7a78f54e-b3dd-4fa6-ae6e-dff2ffd7bdbb&plckPostId=Blog:7a78f54e-b3dd-4fa6-ae6e-dff2ffd7bdbbPost:e472752e-b8d0-4dd5-86e8-2ab90e9fbed&plckScript=blogScript&plckElementId=blogDest>.

²³ See Exhibit 17 below. A block hour is defined as the amount of elapsed time from when an aircraft leaves the gate at its origin until the time when it arrives at the destination gate.

fleet (operated by a variety of regional carriers including Pinnacle collectively referred to as “Delta Connection” carriers) from 325 to 125 or fewer.²⁴

20. Delta’s decision to dramatically reduce the size of its Delta Connection fleet has ominous implications for Pinnacle (and any current Delta Connection carrier that is unable to offer Delta regional lift at competitive rates). Indeed, only two months after announcing that it would substantially reduce its 50-seat flying, Delta also announced that Comair, its wholly-owned regional carrier—whose share of Delta’s regional carrier block hours dropped from 29.4% in 2004 to only 8.5% for the year ending September 30, 2012—will be shut down at the end of September.²⁵ In its letter to employees, Comair’s President noted that the shut-down of Comair “is an unfortunate necessity due to the economic limitations of our aging aircraft, cost structure, the long-term outlook for 50-seat aircraft, and our challenging industry and economy.”²⁶
21. In sum, Pinnacle and other regional carriers are now competing for a declining number of regional carrier flying opportunities available from fewer large network customers who are exerting substantial downward pressure on regional carrier rates and revenues.²⁷ Thus, as demonstrated in Exhibit 6 above, regional carrier profit margins in 2011 reached their lowest level in a decade. Likewise, several once-prominent regional carriers, including Comair, Mesa and American Eagle have sought (or are currently seeking) to restructure under Chapter 11, and some

²⁴ See “Delta Fleet Deal Drops Close to 200 50-Seaters To Gain Larger RJs”, *Aviation Daily*, May 25, 2012. See also “Comair to Cease Operation,” Delta Press Release, July 27, 2012.

²⁵ See Exhibit 19 below and “Comair to Cease Operation,” Delta Press Release, July 27, 2012. A block hour is defined as the amount of time elapsed from when an aircraft leaves the gate at its origin until it arrives at the destination gate.

²⁶ See “Comair to Cease Operation,” Delta Press Release, July 27, 2012.

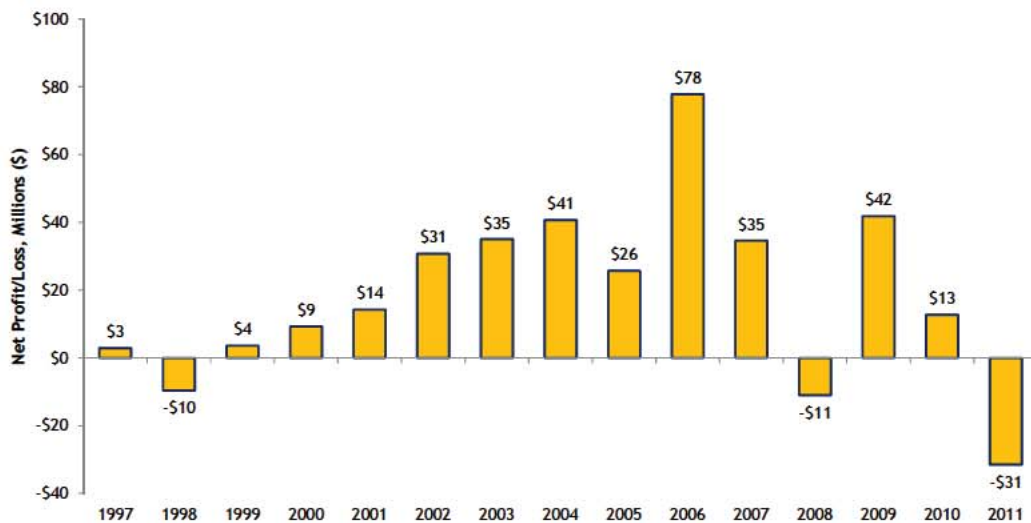
²⁷ See, for example, “When the Music Stops,” *Flight International*, May 3, 2011.

regional carriers including Comair, Atlantic Coast, Air Midwest and Big Sky have (or will soon be) liquidated.²⁸

(iii) Pinnacle Faces an Unprecedented Challenge That Poses a Grave Threat to Its Continued Survival

22. The difficult environment for regional airlines combined with the challenges encountered in integrating the workforces of several formerly separate regional air carriers have dramatically altered Pinnacle's profitability.²⁹ As a result, Pinnacle faces a severe financial crisis that threatens its very existence. As demonstrated by Exhibit 7, Pinnacle lost over \$30 million in 2011.

EXHIBIT 7: PINNACLE'S NET PROFITS: 1997-2011



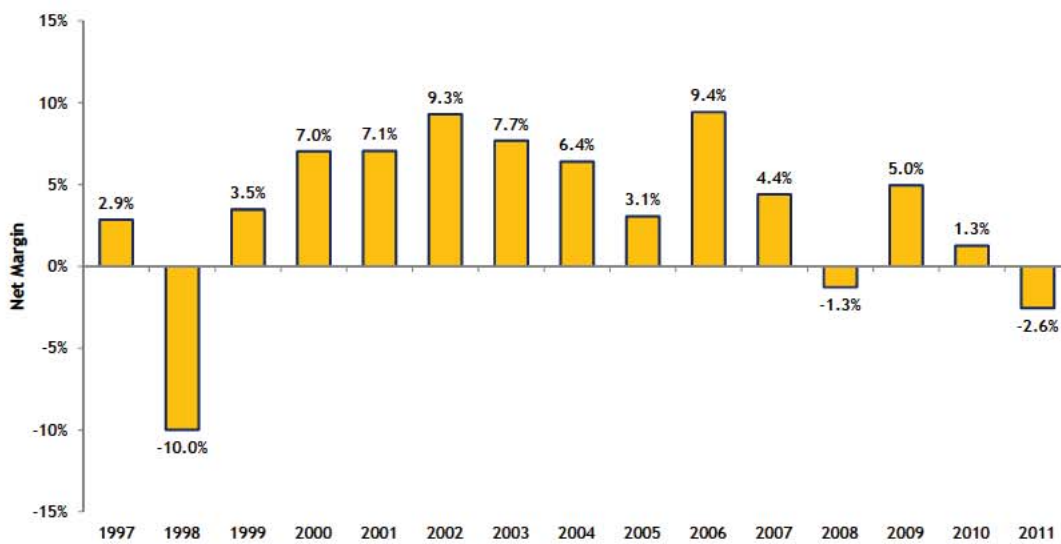
Sources: Pinnacle SEC 10-K and 5-1 filings
Note: 1997 figure is for the 9 months ending December 31, 1997

²⁸ Source: Airlines for America, U.S. Airline Bankruptcies and Service Cessations, <http://www.airlines.org/Pages/U.S.-Airline-Bankruptcies-and-Service-Cessations.aspx>. See also "Comair to Cease Operations," Delta Press Release, July 27, 2012.

²⁹ See Declaration of John Spanjers Pursuant to Local Bankruptcy Rule 1007-2, at paragraph 21-25. In re: Pinnacle Airlines Corp., et al., Chapter 11, United States Bankruptcy Court, Southern District of New York, April 1, 2012, hereafter "First Spanjers Declaration."

23. Likewise, as demonstrated by Exhibit 8, in 2011 Pinnacle's profit margin reached its lowest level since 1998 (the year when Pinnacle's sole customer, Northwest Airlines, suffered a two-week long strike).³⁰

EXHIBIT 8: PINNACLE'S NET PROFIT MARGINS: 1997-2011



Sources: Pinnacle SEC 10-K and S-1 filings
Note: 1997 figure is for the 9 months ending December 31, 1997

24. A key source of Pinnacle's deteriorating financial performance has been its increasing labor costs, which are now substantially higher than those of many of its competitors. In 2011, for example, Pinnacle's flight attendant costs per block hour exceeded those of SkyWest's (another Delta Connection carrier) by more than 20%.³¹ Likewise, Pinnacle's 2011 pilot costs per block hour for its 76-seat CRJ-900 aircraft exceeded those of Trans States subsidiary Compass and Republic

³⁰ Sources: <http://www.nmb.gov/publicinfo/airline-strikes.html>, Pinnacle Airlines Form S-1, and SEC 10-K filings.

³¹ See Exhibit 25 below.

subsidiary Shuttle America (both Delta Connection carriers) by 70% and 38%, respectively.³²

25. To make matters worse, Pinnacle's labor costs will also face substantial upward pressure as a result of the carrier's need to exit unprofitable flying, which will shrink its workforce by over 30%.³³ Pinnacle's downsizing is expected to increase the average seniority among its Captains from [REDACTED] years to [REDACTED] years.³⁴ Since Pinnacle's pilots, flight attendants and other unionized labor groups are paid based on their years of service (i.e., receive a higher hourly wage based on their years of seniority), downsizing will put upward pressure on Pinnacle's labor costs.
26. Pinnacle's labor cost disadvantage versus other regional carriers is also the result of a variety of work rules that limit the productivity of its workforce and the most costly 401k retirement plan contribution of any regional carrier in the industry.³⁵
27. In sum, unless Pinnacle is able to reduce its labor costs, the Company's only remaining contracts going forward (i.e., those with Delta) would be unprofitable.³⁶ Moreover, given the highly commoditized nature of providing regional lift to the large network carriers, Pinnacle must achieve a cost structure that will enable it to successfully compete for new flying opportunities against a number of growing regional carriers such as Compass, GoJet and Shuttle America that enjoy substantially lower cost structures due—in large part—to their substantially less

³² See Exhibit 29 below. Compass' 76-seat flying for Delta Connection is operated using E-175 regional jets.

³³ Sources: 6.15 120523 data & assumptions for ALPA.Confidential.xlsx, and 7.5 120525 Pinnacle FA model for USW_final_data, assumptions, work rules.Confidential.xlsx

³⁴ Source: Analysis of 6.46 120817 Data & Assumptions for ALPA.CONFIDENTIAL.xlsx.

³⁵ See Declaration of Jerrold Glass In Support Of Pinnacle Airlines Corp.'s Motion To Reject Collective Bargaining Agreements With The Air Line Pilots Association, International, and The Association of Flight Attendants-CWA, Pursuant To 11 U.S.C. § 1113, September 13, 2012 (hereafter "Declaration of Jerry Glass").

³⁶ See Testimony of Sean Menke, May 16, 2012, at pages 135 and 157.

senior workforces. Simply put, absent labor cost savings, the Company will continue to cede flying to lower cost competitors, bleed cash and ultimately face liquidation.³⁷ If, on the other hand, Pinnacle can reduce its labor costs to the targets contained in the Company's business plan, it will achieve a cost structure that enables it to effectively compete for new flying opportunities thereby establishing a platform for future growth with Delta and/or other network carriers.

28. The remainder of my declaration is organized as follows. Section III provides background information on the role of regional carriers in today's hub-and-spoke networks, the economics of regional carriers, as well as the current challenges facing the regional airline industry. Section IV provides an overview of Pinnacle and its competitors. Section V discusses the reasons why Pinnacle must reduce its labor costs in order to be in a position to retain (and potentially expand) its flying for Delta and to compete for new flying opportunities for other large network carriers. Section VI summarizes my conclusions.

III. BACKGROUND ON THE REGIONAL AIRLINE INDUSTRY

(i) The Role of Regional Carriers in a Hub-and-Spoke Network

29. Each of the large network carriers operates a "hub-and-spoke" network.³⁸ A hub is a centralized point in an airline's route network to which flights are routed so as to

³⁷ As noted by one industry observer following Delta's announcement that it planned to remove approximately 200 50-seat RJs from its Delta Connection fleet: "The Great Regional Feeding Frenzy of 2012 can now begin. I expect to see some carcasses... If things don't change dramatically, I wouldn't be surprised to see Pinnacle disappear (along with a lot of flights in Memphis). At the very least, it's going to be a lot smaller... To me there seems to be a very clear line. Comair and Pinnacle will be lucky to still exist after the dust settles while the rest all can gain something." *Source:* <http://crankyflier.com/2012/07/03/deltas-new-pilot-contract-kicks-off-the-great-regional-feeding-frenzy-of-2012/>.

³⁸ The use of hubs is not limited to the large network airlines. JetBlue, for example, consolidates its connecting traffic at New York (JFK) and Boston, while Spirit Airlines operates a hub at Fort Lauderdale. Similarly, Southwest Airlines, the largest LCC known for its point-to-point service model, combines traffic flows at airports such as Baltimore, Houston/Hobby, Chicago/Midway and Phoenix to provide its

allow passengers to make connections between numerous origin and destination points. By combining passengers from various spoke cities at a central hub, each flight between the hub and a spoke city is able to carry passengers traveling to or from many different cities.

30. When new spoke cities are added, airline networks exhibit positive network “spillover effects” because each newly added spoke creates multiple new connecting opportunities through the hub.³⁹ These new routings generate additional “flow” traffic on other routes served from the hub, which, in turn, supports additional flights.⁴⁰ In short, routing traffic through a hub enables an airline to provide more frequent service to more cities than would be possible if it had to rely solely on local traffic.⁴¹ As shown in Exhibit 9, over 95% of all domestic city pairs generate 50 or fewer O&D passengers per day. Since this number of passengers is typically insufficient to support non-stop service, the ability to combine local and “flow” traffic on the same flights using a hub-and-spoke network is a critical feature of a network airline’s economic viability.

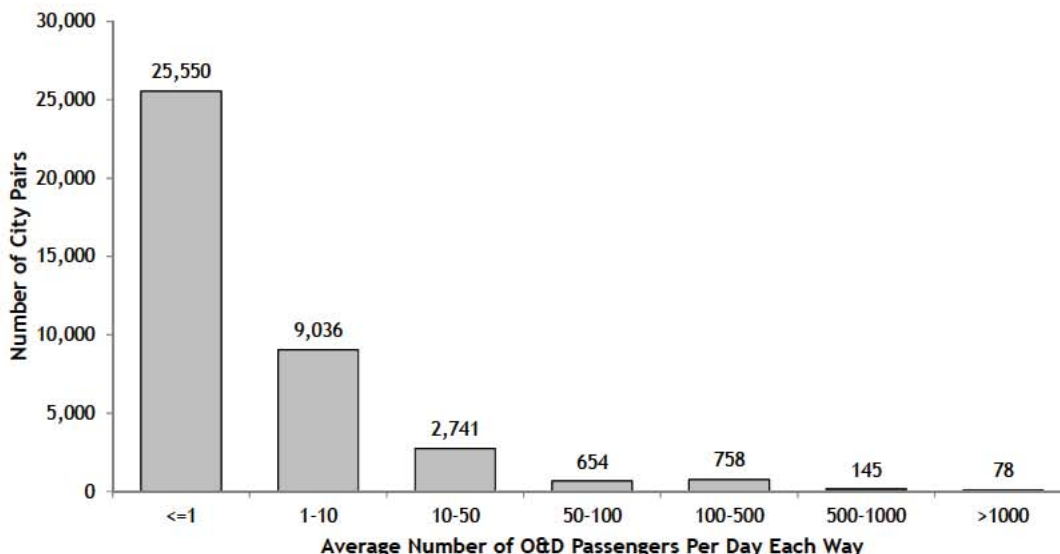
passengers with access to one- or two-stop routings for longer trips. Similarly, AirTran (now part of Southwest) operates a large hub in Atlanta.

³⁹ For example, if a hub with 100 unique spoke destinations adds one additional spoke, passengers from the newly added destination can travel to each of the 100 pre-existing spokes via the hub.

⁴⁰ Moreover, by combining traffic flows at a central hub airport, an airline can increase the “density” (i.e., the number of passengers) on each of the hub-to-spoke routes, thus allowing it to use larger, more cost efficient aircraft than would otherwise be feasible. Similarly, combining traffic flows at hubs enables network carriers to provide greater flight frequency than they otherwise could.

⁴¹ “Local” traffic refers to passengers who are traveling between the two endpoints of a flight rather than using the flight as an intermediate leg of their journey. It is noteworthy that hubs evolved in many businesses and all network industries, not just airlines, precisely because they are highly efficient in moving customers (as well as products and electronic signals, among others) between multiple points spread across large geographic areas. In the telecommunications industry, for example, calls from one residence or business to another are routed through a hub known as a “central office.” Just as it would be inefficient for each pair of houses within a city to be connected via separate telephone lines, so too is it inefficient (and prohibitively expensive) for airlines to provide non-stop service between all city-pairs.

EXHIBIT 9: DISTRIBUTION OF DOMESTIC CITY-PAIRS BY O&D PASSENGERS, 2011



Source: U.S. DOT DB1B database.

Notes: Domestic. Airports in the following domestic metropolitan areas are grouped: Chicago (ORD, MDW), Cincinnati (CVG, DAY), Cleveland (CLE, CAK), Dallas (DFW, DAL), Houston (HOU, IAH), Los Angeles (LAX, BUR, LGB), Miami (MIA, FLL), New York (LGA, JFK, EWR), San Francisco (SFO, OAK), Washington DC (DCA, IAD, BWI), Phoenix (PHX, AZA) and Tampa (TPA, PIE).

31. In sum, hubbing enables airlines to build economically viable levels of traffic on routes by combining traffic moving to and from scores of different airports (including many small communities that can only be served economically by regional carriers). Hubbing thus makes it possible for airlines to serve thousands of individual city-pairs that do not generate sufficient traffic to support direct (point-to-point) service.
32. The primary role of regional carriers is to provide safe, reliable and cost-effective lift on routes (or at times of day) where traffic is insufficient to support economically viable service using larger mainline aircraft. Although regional carrier flights (by definition) are not *operated* by the mainline partner, regional aircraft and flights display the livery and also adopt the marketing code (i.e.,

brand) of the mainline partner, and thus, from the point of view of the passenger, represent integrated service on a single carrier.⁴²

33. Regional carriers play a crucial role in the hub-and-spoke networks of all large network carriers. Many small- and medium-sized communities (e.g., Akron, Huntsville, Ithaca, etc.) do not consistently generate sufficient traffic to support service by the mainline aircraft. By connecting small- and medium-sized communities with larger carriers' hubs, regional carriers expand the scope of large carrier networks and provide passengers from these communities with access to those carriers' global route network.
34. By enabling large network carriers to economically provide service to smaller communities, regional carriers also help large network carriers to differentiate their services from those provided by LCCs, which tend to focus the bulk of their service on larger, more heavily-traveled, routes. While LCCs compete with large network carriers on approximately 95% of city-pairs generating 500 or more passengers per day, they only serve 9% of the more than 37,000 domestic city-pairs that generate fewer than 50 O&D passengers per day.⁴³ Even though these city-pairs are small individually, they generate, in aggregate, nearly 22% of all domestic passenger revenue.⁴⁴
35. Likewise, regional carriers also provide network carriers with the ability to deploy a smaller aircraft at times of the day when passenger demand is insufficient to support a larger mainline jet. By deploying a regional aircraft at off-peak times of the day, large network carriers can offer passengers greater flight frequency (and,

⁴² Unlike bilateral "codeshare" agreements between mainline carriers (e.g., Delta Airlines and Alaska Airlines), the codeshare agreements between regional carriers and their mainline partner are *unilateral*, in the sense that the two-letter code of the mainline partner (e.g., DL) is placed on flights operated by Pinnacle, but not vice-versa.

⁴³ *Source:* Analysis of U.S. DOT DB1B database.

⁴⁴ *Source:* Analysis of U.S. DOT DB1B database.

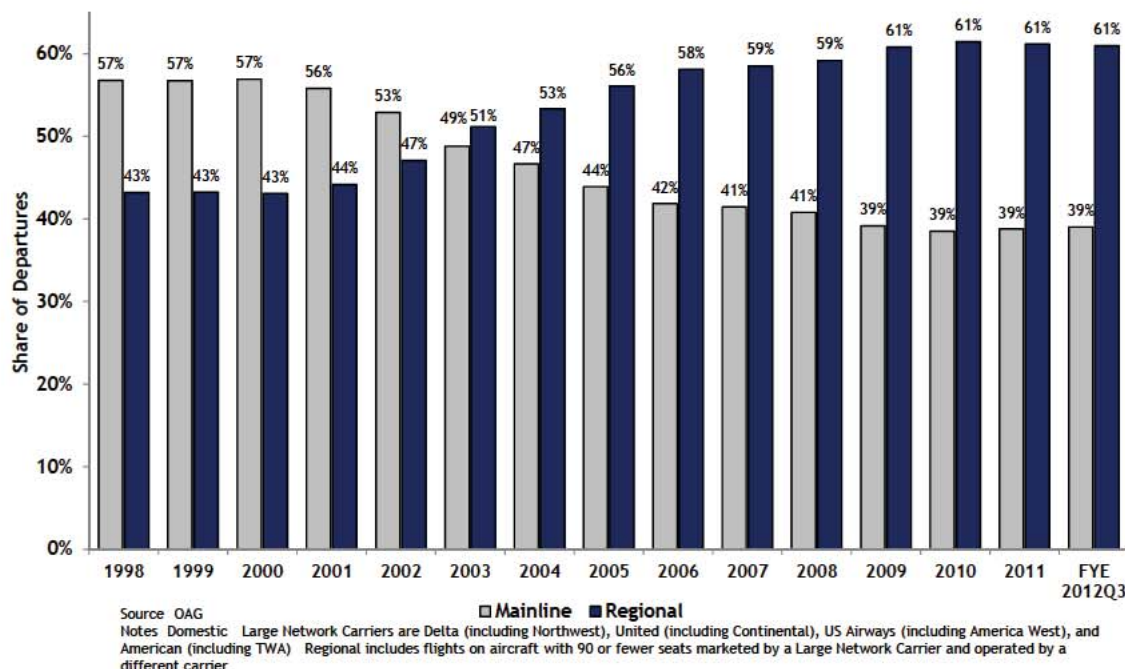
thus, schedule options) than would be possible if they were limited to using only larger mainline jets. The ability to offer greater flight frequency by mixing both mainline and regional jets is particularly important for attracting higher yielding business travelers who value—and are willing to pay a premium over LCC fares for—greater flight frequency.

36. As demonstrated by Exhibit 10, regional carriers have accounted for an increasing share of domestic flights offered by large network carriers over the past decade and a half. This shift to regional carriers is a result of several factors, including: (1) increased competition from LCCs, which have nearly doubled their share of domestic O&D passengers from 19.5% to 38% since 1998, primarily at the expense of large network carriers;⁴⁵ (2) the advent of regional jets, which greatly increased the mission capabilities (i.e., range, speed, capacity and comfort) of regional aircraft, especially vis-à-vis older generation turboprop aircraft;⁴⁶ and (3) the Chapter 11 restructurings of Delta, Northwest, United and US Airways, which dramatically increased the flexibility those carriers have to deploy RJs—especially 70-seat and larger RJs—to better match supply and demand across routes.

⁴⁵ See Exhibit 1 above.

⁴⁶ See, for example, Pinnacle Airlines Corp. 2010 10-K, page 6: “The growth in the number of passengers using regional airlines and the revenues of regional airlines during the last two decades is attributable primarily to the introduction of regional jet aircraft and their popularity with major airlines. Major airlines sought to add regional jet aircraft in many markets to replace smaller turboprop aircraft and slightly larger narrowbody aircraft. By adding regional jet aircraft, hub and spoke carriers were able to increase the scope of their network by serving markets that could not be supported by larger narrowbody aircraft, reduce the operating cost in markets previously supported by larger narrowbody aircraft, and increase the level of passenger service in smaller markets previously serviced with smaller turboprop aircraft.”

**EXHIBIT 10: PROPORTION OF LARGE NETWORK CARRIER DOMESTIC FLIGHTS,
MAINLINE VS. REGIONAL, 1998-FYE2012Q3**



(ii) Types of Regional Carriers

37. Regional carriers fall into one of two broad categories: *wholly-owned* and *independent*. As their name implies, wholly-owned regionals are owned by their mainline partner (or the holding company of their mainline partner): e.g., Comair was a wholly-owned subsidiary of Delta Air Lines; Piedmont and PSA are wholly-owned subsidiaries of US Airways Group; and American Eagle and Executive Airlines are wholly-owned subsidiaries of AMR Corporation.⁴⁷ With a few minor

⁴⁷ See US Airways Form 2011 10-K, page 7, AMR Corporation 2011 Form 10-K, page 1 and Delta Air Lines 2011 Form 10-K, page 2. As noted earlier, Delta has announced that will be shutting down Comair at the end of September. See "Comair to Cease Operation," Delta Press Release, July 27, 2012.

exceptions, wholly-owned regional carriers provide lift exclusively to their mainline parents.⁴⁸

38. Independent regional carriers, on the other hand, are not owned by a mainline carrier, and frequently fly on behalf of multiple large network carriers. Several of today's independent regional carriers were previously wholly-owned, but were divested by their mainline owners.⁴⁹ Exhibit 11 shows that six of the ten largest regional carriers (including five of the six largest) in terms of ASMs are now independent.⁵⁰ Further, as discussed above, Delta has announced that Comair will be shut down at the end of September.⁵¹

⁴⁸ One exception is Horizon Airlines (a wholly-owned subsidiary of Alaska Air Group), which also provided regional lift to LCC Frontier between 2004 and 2007 at its Denver hub under a capacity purchase agreement. See "Frontier Airlines and Horizon Air to Launch Inaugural Regional Jet Flight," Frontier Airlines Press Release, December, 31, 2003 and "Frontier Airlines Selects Republic Airlines as Regional Partner to Operate New Fleet of Embraer 170 Aircraft Republic to Deliver 17, 76-Seat Embraer 170 Regional Jet Aircraft Over Next 23 Months," Frontier Airlines Press Release, January, 11, 2007.

⁴⁹ As noted earlier, Continental Airlines owned ExpressJet before spinning it off in 2002 and Northwest Airlines previously owned Pinnacle Airlines before spinning it off in 2003. Likewise, Delta sold Atlantic Southeast to SkyWest in 2005 and Mesaba Airlines to Pinnacle Airlines Corp. in 2010. See "ExpressJet Announces Pricing of Initial Public Offering", Continental Airlines Press Release, April, 17, 2002; "Continental Airlines Sells ExpressJet share," *Houston Chronicle*, February 12, 2007; "Pinnacle Airlines Announces Initial Public Offering," Pinnacle Airlines Corp. Press Release, November, 24, 2003; "Delta Air Lines Reaches Definitive Agreement To Sell Atlantic Southeast Airlines to SkyWest," Delta Air Lines Press Release, August 15, 2005; and "Pinnacle Airlines Corp. Acquires Mesaba Aviation, Inc.," Pinnacle Airlines Corp. Press Release, July 1, 2010.

⁵⁰ This is in stark contrast to 2000, when the four largest regional carriers (American Eagle, Comair, Atlantic Southeast and Express Jet) were wholly-owned by their mainline partners. See Regional Airline Association 2001 Annual Report, page 12.

⁵¹ See "Comair to Cease Operation," Delta Press Release, July 27, 2012.

**EXHIBIT 11: TEN LARGEST REGIONAL CARRIERS AND THEIR MAINLINE
PARTNER(S), FYE 2012-Q3**

	Regional Carrier	Ownership	Mainline Partners	FYE 2012Q3 ASMs (millions)
1	SkyWest	Independent	United, Delta, Alaska Airlines, US Airways	37,002
2	AMR Eagle	Wholly Owned	American	13,956
3	Republic	Independent	US Airways, United, Delta, American	11,411
4	Pinnacle Airlines	Independent	Delta, United*, US Airways*	10,555
5	Trans States	Independent	Delta, United, US Airways	6,991
6	Mesa Airlines	Independent	US Airways, United	4,299
7	PSA/Piedmont	Wholly Owned	US Airways	3,298
8	Air Wisconsin	Independent	US Airways	2,875
9	Horizon Air	Wholly Owned	Alaska Airlines	2,648
10	Comair	Wholly Owned	Delta	2,504

* Pinnacle's United and US Airways contracts are being were terminated by September 5, 2012.

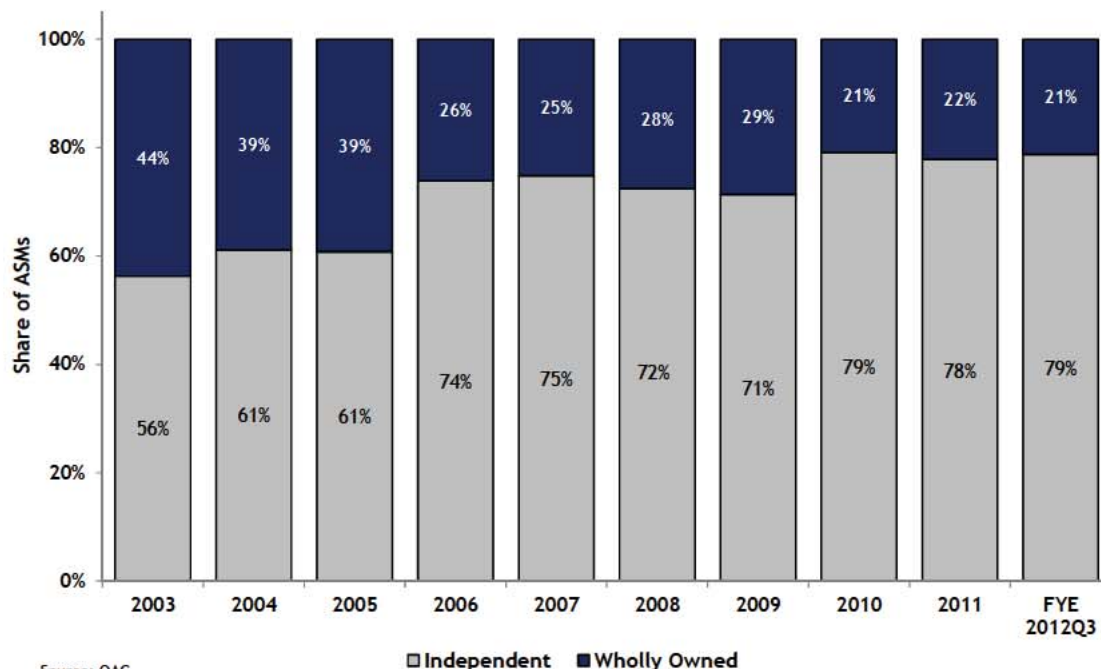
Source: OAG, 2011 and 2012.

Notes: SkyWest includes SkyWest, ASA and ExpressJet; AMR Eagle includes American Eagle and Executive; Republic includes Republic, Chautauqua, Shuttle America and Lynx; Mesa includes Mesa, Air Midwest and Freedom; Trans States includes TransStates, Compass and GoJet; Pinnacle includes Pinnacle, Mesaba and Colgan.

39. The growth of independent regional carriers such as SkyWest, Pinnacle and Republic is attributable to the fact that they have developed reputations for safety and reliability that are comparable to wholly-owned regional carriers. In addition to strong reputations for safety and reliability, the most successful and fastest growing independent regionals have also focused on keeping their costs contained, and, thus, have been able grow their share of regional carrier capacity by successfully competing for new flying opportunities.⁵² Exhibit 12 demonstrates that independent regional carriers have grown their share of regional capacity from 56% in 2003 to 79% for the full year ending 2012 Q3.

⁵² For example, SkyWest, the largest regional carrier in the country, recently announced an agreement to acquire 100 new 70-90 seat Mitsubishi regional jets starting in 2017. See "Mitsubishi Aircraft and SkyWest, Inc. Announce 100 Aircraft Agreement in Principle," Mitsubishi Aircraft Corporation Press Release, July 11, 2012.

EXHIBIT 12: SHARE OF REGIONAL CARRIER ASMs, WHOLLY-OWNED VS. INDEPENDENT REGIONAL CARRIERS, 2003-FYE 2012 Q3



(iii) Economics of Regional Carriers

a. Pro-Rate vs. Capacity Purchase Agreements

40. Regional carriers contract with large network carriers using one of two models: pro-rate or capacity purchase. Prior to the introduction of RJs in the late 1990s, a substantial portion of regional flying was conducted under “pro-rate” agreements.⁵³ Under a pro-rate agreement—which today tend to be focused on

⁵³ See *Straight and Level: Practical Airline Economics*, Third Edition, Stephen Holloway, Ashgate: October, 2008, Page 382, “Until 2001, US majors and non-owned regionals tended to cooperate under prorate agreements, which left regionals bearing some of the commercial risk as well as the operating responsibility. Since the majors began down-gauging their domestic networks in 2001-2002 by handing routes over to regionals, common practice has been to enter into capacity purchase agreements (CPAs) under which regionals are paid on either a cost-plus, a fee-per-departure, or a fee-per-ASM basis.” See also

small turbo-prop flying and often on subsidized Essential Air Services (“EAS”) routes to small communities⁵⁴—both the regional and the mainline carrier share the risk associated with passenger demand, fares and fuel prices. Pinnacle, through its Colgan subsidiary, formerly operated a limited amount of pro-rate flying on behalf of United and US Airways, but has eliminated that flying due to its lack of profitability.⁵⁵

41. The bulk of today’s contracts between regional and mainline carriers are structured as “capacity purchase agreements,” whereby the regional carrier supplies lift to its mainline partner using regional aircraft (i.e., turboprops and RJs) in exchange for a fixed fee (i.e., a fixed dollar rate per block hour, day or departure) reimbursement of certain “pass through” costs (e.g., fuel, landing fees, etc.), and, potentially, other “incentive” payments if the regional carrier achieves specified levels of operational performance (e.g., on-time performance or completion factor).⁵⁶
42. A key element of a capacity purchase agreement is that the regional carrier receives the fixed payment per flight *irrespective of the number of passengers*

“The Role of Regional Airlines in the U.S. Airline Industry,” Silke Januszewski Forbes and Mara Lederman, in *Advances in Airline Economics, Volume 2*, Darin Lee, Editor, page 200: “In the case of an independent regional, the contract between the major and the regional will generally take one of two forms. Historically, most contracts have been revenue-sharing agreements (also known in the industry as pro-rate agreements).”

⁵⁴ EAS routes are routes between small U.S. communities and a large network carrier’s hub that receive a subsidy from the U.S. Department of Transportation. Absent these subsidies, the U.S. DOT notes that these communities would not receive commercial air service. See http://ostpxweb.dot.gov/aviation/x-50%20role_files/essentialairservice.htm.

⁵⁵ See First Spanjers Declaration, paragraph 27 and Pinnacle Form 8-K, July 9, 2012 (Letter from John Spanjers to all employees).

⁵⁶ See, for example, Republic Airways Holdings 2010 10-K, page 56: “Under our fixed-fee arrangements with our Partners, the Company receives fixed-fees for our capacity purchase agreements, as well as reimbursement of specified “pass-through” costs on a gross basis with additional possible incentives from our Partners for superior service.” See also AMR Eagle Form 10, page 78: “Under a capacity purchase contract, the mainline carrier generally purchases the entire capacity of a set number of aircraft and schedules the routes those aircraft fly. The mainline carrier pays the regional airline a fixed-fee for each departure, with additional incentives based on performance metrics, including completion of flights and on-time performance.”

carried or the fares they pay. Put differently, under a capacity purchase agreement all of the revenue risk associated with passenger demand (as well as fuel price fluctuations) is assumed by the mainline carrier.⁵⁷ Similarly, under a capacity purchase agreement the mainline carrier is responsible for the sales and marketing of tickets, yield management and determining the schedule (i.e., the routes and flight times) of the regional carrier.

43. Because the regional carrier's revenue under a capacity purchase agreement is based on a formula that is independent of the number of passengers carried or the fares paid by passengers, the key determinant of a regional carrier's ability to earn a profit is its ability to keep its costs in check.⁵⁸ Moreover, since capacity purchase agreements typically dictate that many types of costs (including fuel, landing fees, aircraft ownership costs, insurance, etc.) are passed along to the mainline carrier, labor is, by a wide margin, the largest controllable cost for a regional carrier.⁵⁹ Thus, more than two thirds of Pinnacle's total operating expenses (net of pass

⁵⁷ See Pinnacle Airlines Corp. 2010 Form 10-K, page 7: "Under CPAs, our major airline partners purchase our flying capacity by paying pre-determined rates for specified flying, regardless of the number of passengers on board or the amount of revenue collected from passengers." See also, AMR Eagle Form 10, page 78: "In addition, the mainline carrier and regional airline often enter into a contract pursuant to which the mainline carrier bears the risk of changes in the price of fuel and other such costs that are passed through to the mainline carrier partner. Regional airlines benefit from a capacity purchase contract because they are sheltered from most of the elements that cause volatility in airline earnings, including variations in ticket prices, passenger loads and fuel prices."

⁵⁸ As discussed in Section V below, unlike mainline carriers, regional carriers have far less control over other aspects of their operations, network, product and cost structure than do mainline carriers, and thus, can do little outside of keeping their labor and other administrative costs in check in order to be able to offer large network carriers competitive rates while also earning a profit margin sufficient to warrant continued investment in the business.

⁵⁹ See Republic Airways Holdings Form 2010 Form 10-K, page 56: "The reimbursement of specified costs, known as "pass-through costs", may include aircraft ownership cost, passenger liability and hull insurance, aircraft property taxes, fuel, landing fees and catering." See also, AMR Eagle Form 10, page F-10: "Pass-through costs, which are not subject to margin, include jet fuel, into-plane fueling, insurance, landing fees, aircraft ownership and rent, air traffic control user fees, aircraft property taxes, and certain engine maintenance costs, while rent at hub stations are absorbed by American."

through costs) represent employee wages, salaries, benefits and other personnel expenses.⁶⁰

b. The Shift from Pro-Rate to Capacity Purchase Agreements Transformed Regional Airline Services Into a Largely Commodity Business

44. Because capacity purchase agreements have shifted all of the route planning, revenue management, fuel volatility and passenger demand risk to the mainline carrier, the regional airline industry has largely become a commodity business, with each of the large network carriers relying on a variety of different regional carriers. As demonstrated by Exhibit 13, Delta currently diversifies its regional lift requirements across Pinnacle and four other regional carriers (or regional carriers' holding companies).⁶¹ Likewise, for the year ending September 30, 2012, United and US Airways relied on eight and seven different regional carriers, respectively.⁶²

⁶⁰ See Exhibit 20 below.

⁶¹ As noted earlier, Delta is shutting down Comair at the end of September.

⁶² American is currently subject to a number of restrictions that limit its ability to source regional lift from its independent regional carriers, but has sought to relax these restrictions from its CBA with its pilots union as part of its bankruptcy restructuring.

**EXHIBIT 13: REGIONAL CARRIER PARTNERS OF THE LARGE NETWORK CARRIERS,
FYE 2012 Q3**

Network Carrier		Regional Partner	Ownership	FYE 2012Q3 Share of Network Carrier's Regional ASMs
American	1	AMR Eagle	Wholly Owned	97.1%
	2	Republic	Independent	2.9%
Delta	1	SkyWest	Independent	39.6%
	2	Pinnacle Airlines	Independent	29.7%
	3	Trans States	Independent	13.3%
	4	Republic	Independent	9.3%
	5	Comair	Wholly Owned	8.1%
United	1	SkyWest	Independent	72.2%
	2	Republic	Independent	10.0%
	3	Trans States	Independent	8.0%
	4	Mesa Airlines	Independent	4.2%
	5	Pinnacle Airlines*	Independent	3.9%
	6	Commutair	Independent	1.1%
	7	Silver Airlines	Independent	0.5%
	8	Cape Air	Independent	0.1%
US Airways	1	Republic	Independent	33.2%
	2	PSA/Piedmont	Wholly Owned	22.5%
	3	Mesa Airlines	Independent	19.9%
	4	Air Wisconsin	Independent	19.6%
	5	SkyWest	Independent	2.8%
	6	Trans States	Independent	1.6%
	7	Pinnacle Airlines*	Independent	0.4%

* Pinnacle's United and US Airways contracts were terminated as of September 5, 2012.

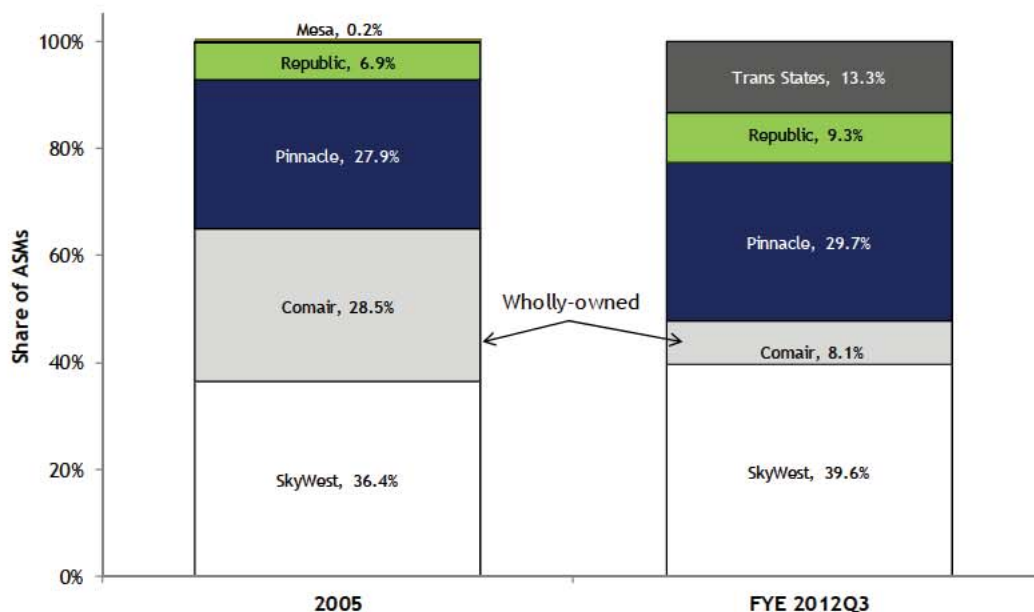
Source: OAG; Pinnacle 8-K, July 9, 2012 (Letter from John Spanjers to All employees).

Notes United including Continental. SkyWest includes SkyWest, ASA and ExpressJet; Republic includes Republic, Chautauqua, and Shuttle America; Trans States includes Trans States, Compass and GoJet; Pinnacle includes Pinnacle, Mesaba and Colgan.

45. Further evidence that regional lift has become a commoditized business is the fact that United, Delta and US Airways all substantially changed the composition of their regional lift portfolios after emerging from Chapter 11. In particular, all three greatly reduced their reliance on higher cost wholly-owned regional carriers, and allocated the bulk of their regional flying to lower cost, independent regional

carriers.⁶³ Exhibit 14 illustrates the change in Delta's regional carrier portfolio between 2005 and the FYE 2012-Q3. It shows that Comair's (Delta's wholly-owned regional carrier that is shutting down at the end of September) share of Delta Connection ASMs fell from 28.5% to 8.1%, while independent regional carriers Pinnacle, Republic, SkyWest and Trans States all gained share.⁶⁴

EXHIBIT 14: SHARE OF DELTA CONNECTION ASMs BY REGIONAL CARRIER PARTNER, 2005 vs. FYE 2012 Q3



Source: OAG.

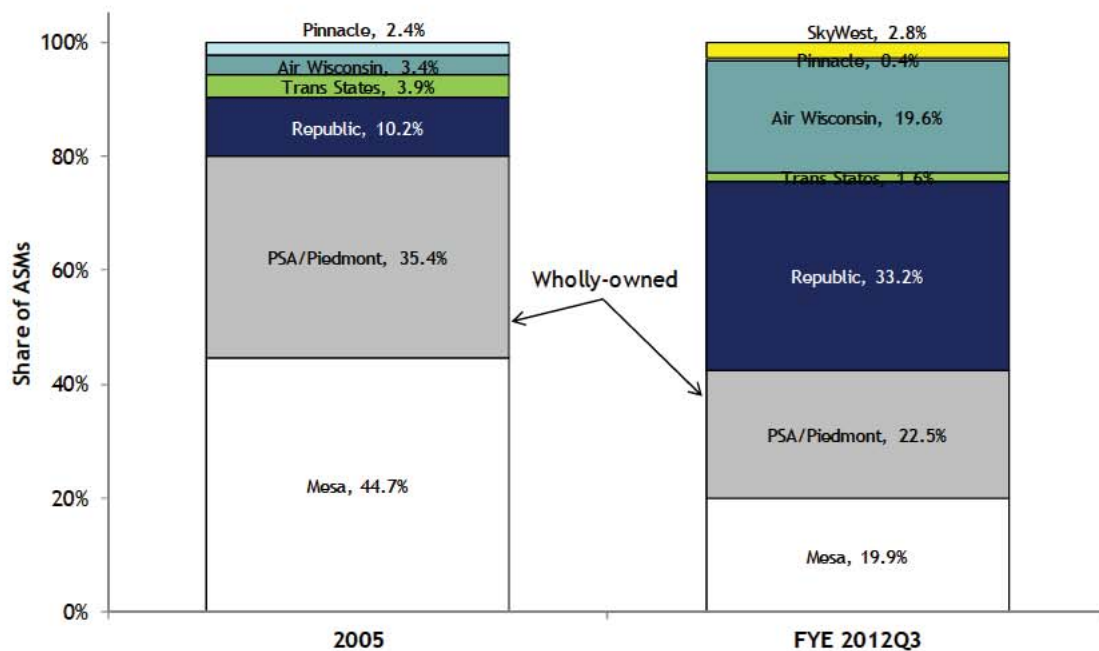
Notes: Delta includes Northwest. Mesa includes Mesa and Freedom; SkyWest includes SkyWest, ASA, and ExpressJet; Pinnacle includes Pinnacle and Mesaba; Republic includes Republic, Chautauqua, and Shuttle America; Trans States includes Trans States, Compass and Gojet.

⁶³ United relied exclusively on independent regional carriers both prior to and after its Chapter 11 restructuring. As noted above, Continental (recently merged with United) had owned ExpressJet before spinning it off in 2002. See "ExpressJet Announces Pricing of Initial Public Offering," Continental Airlines Press Release, April, 17, 2002; "Continental Airlines Sells ExpressJet Share," *Houston Chronicle*, February 12, 2007.

⁶⁴ Moreover, Exhibit 14 understates the shift of Delta Connection flying from wholly-owned to independent regional carriers since (as noted in footnote 49 above) Delta sold ASA to SkyWest and Mesaba to Pinnacle in 2005. Including those carriers' ASMs as wholly-owned in 2005 would reduce Delta's use of wholly-owned ASMs from 63.3% in 2005 to 8.1% in 2012-Q3. Moreover, once Delta completes its shut-down of Comair in September, 100% of its regional lift will be provided by independent regional carriers.

46. Similarly, Exhibit 15 shows the substantial change in the composition of regional flying by US Airways Express regional carriers between 2005 and the FYE 2012-Q3. In particular, the proportion of US Airways Express' capacity allocated to US Airways' wholly-owned regional carriers (PSA, Piedmont and MidAtlantic) dropped from 35.4% to 22.5%, while the share of independent regional carriers Republic and Air Wisconsin grew sharply.

EXHIBIT 15: SHARE OF US AIRWAYS EXPRESS ASMs BY REGIONAL CARRIER PARTNER, 2005 vs. FYE 2013Q2



Source: OAG.

Notes: US Airways includes America West. Pinnacle includes Mesaba and Colgan (in 2011); Republic includes Chautauqua, Shuttle America and Lynx; Trans States includes Compass, and Gojet; Mesa includes Air Midwest and Freedom.

(iv) The Challenges Facing Regional Carriers Are Increasing

47. As discussed in Section II above, a variety of competitive factors and external shocks (e.g., proliferation of LCCs, price transparency resulting from the Internet, high fuel prices and a reduction in short-haul passenger demand since September 11th) exacted a costly toll on the large network carriers, which, in turn, contributed

to over \$30 billion in operating losses since 2001 and each of the surviving large network carriers restructuring under Chapter 11 bankruptcy.

48. Many of the same challenges that caused the large network carriers to restructure have “spilled over” to the regional carriers. For example, the decline in short-haul demand (i.e., trips of less than 500 miles) due to the “hassle factor” has resulted in the loss of approximately 30 million annual short-haul O&D passengers.⁶⁵ Because regional carriers predominantly fly on routes of less than 500 miles,⁶⁶ the demand for regional carrier services by the large network carriers has been particularly hard-hit by the reduction in short-haul traffic arising from the hassle factor.
49. Similarly, although the sharp rise in the price of jet fuel has put pressure on all carriers, it has been particularly severe for regional carriers, since, as shown in Exhibit 16, 50-seat (and smaller) RJs—which still form the backbone of the regional carrier industry and comprise the bulk of Pinnacle’s fleet⁶⁷—consume 55% to 126% more fuel per seat hour than small mainline jets such as the Boeing 737 or Airbus A-320, and thus, have become far less economic than before.⁶⁸ Thus, one industry observer has recently noted that it costs an airline 25 cents per

⁶⁵ *Source*: Analysis of U.S. DOT DB1B Survey data.

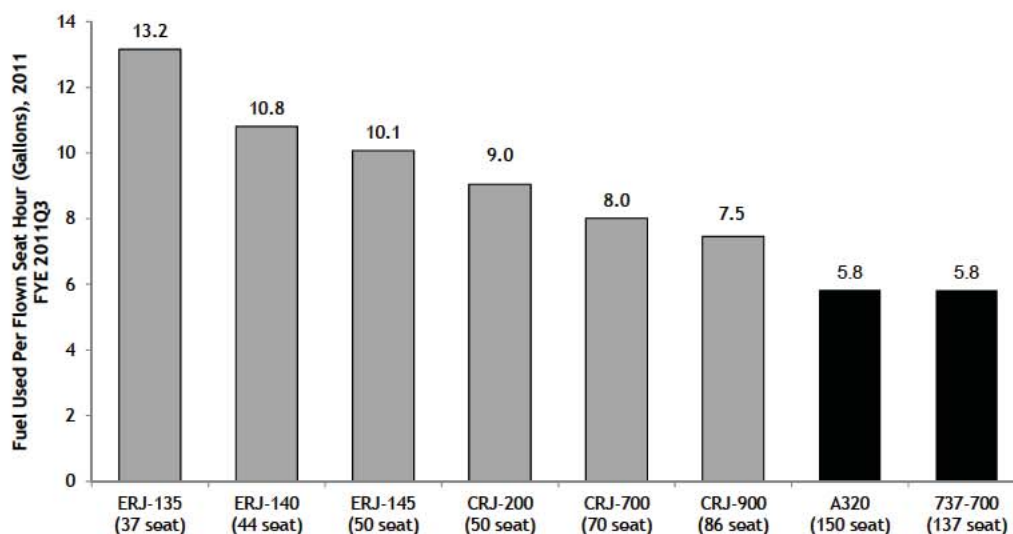
⁶⁶ In July 2012, 65% of regional carrier flights were 500 miles or less. *Source*: OAG.

⁶⁷ In 2011, 50-seat and smaller RJs accounted for 65.6% of total RJ block hours for the large network carriers. *Source*: OAG. Pinnacle’s fleet currently consists of 140 50-seat CRJ-200s and 41 76-seat CRJ-900s. *See* Pinnacle Form 8-K, August 17, 2012 (Letter from John Spanjers to All Employees regarding Business Plan Update, August 16, 2012).

⁶⁸ *See also* “Distress Call: More Worries Arise for U.S. Regional Carriers,” *Aviation Week & Space Technology*, November 21, 2011: “Many regional carriers are having a difficult time with 50-seat aircraft, which have become unsuitable for many markets because of high fuel costs and the limited number of seats over which to spread the higher costs....”

passenger-mile to fly a 50-seat RJ, compared to 10 cents per mile using a 150-seat Boeing 737 on routes of the same distance.⁶⁹

EXHIBIT 16: FUEL CONSUMPTION PER SEAT HOUR OF REGIONAL JETS VS. SMALL NARROW-BODY AIRCRAFT



Source: U.S. DOT Form 41.

Notes: Calculated as Air Fuels Used / Total Air Hours / Seats, where Seats are the based on the configuration shown in the exhibit.

50. Moreover, recent mergers among the large network carriers have reduced both the demand for small RJs and the number of potential customers for regional carrier services. As noted by one industry observer, “The USA’s regional carriers are jockeying for position as the majors they feed consolidate. But the disadvantage of operating small jets is putting pressure on the traditional business model.... Now airlines find themselves jockeying for business from a shrinking pool of network carriers, based at a small number of hub airports. With the consummation of

⁶⁹ See “Skies friendly to small jets,” *Grand Junction Sentinel*, January 5, 2012. http://www.gjsentinel.com/news/articles/skies_friendly_to_small_jets. See also “Airlines Cut Small Jets as Fuel Prices Soar,” *USA Today*, November 28, 2011, noting that “A Delta 50-seat CRJ-200 made by Bombardier takes 19 gallons of fuel to fly each passenger 500 miles. Fuel usage drops to just 7.5 gallons per passenger on Delta’s 160-seat MD-90s over the same distance.”

United and Continental's merger in late 2010, just four US network groups exist, leaving fewer chairs in the game.”⁷⁰

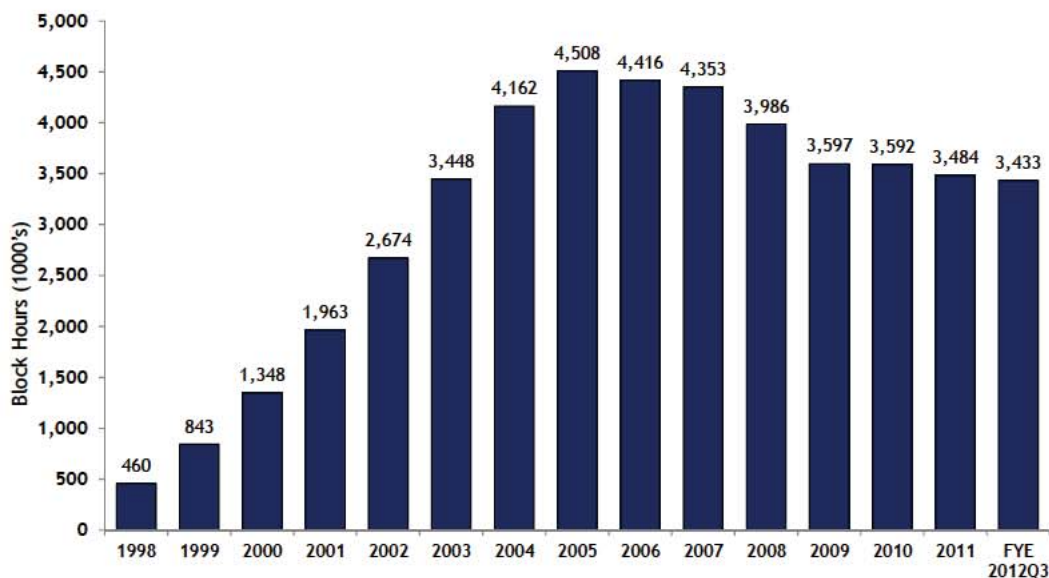
51. As a result, the use of 50-seat and smaller RJs by the large network carriers has greatly diminished and is expected to decline even further in the future.⁷¹ As demonstrated by Exhibit 17, the large network carriers have already eliminated more than one million annual 50-seat (or smaller) RJ block hours between 2005 and the full year ending September 30, 2012, a decrease of almost 25%, and, as recently as May of this year, Delta announced that it intends to reduce the number of 50-seat RJs in its Delta Connection fleet by more than 60%, from 325 to 125 or fewer.⁷²

⁷⁰ Source: “When the Music Stops,” *Flight International*, May 3, 2011.

⁷¹ As noted in the First Quarter 2010 edition of *Regional Horizons* at page 8: “‘Going forward, we believe regional carriers have limited opportunities for organic growth,’ Raymond James analysts said. ‘While legacy carriers will seek to outsource more flying to larger regional jets over time, in our view, this growth will be offset by a reduction of smaller 50-seat regional jets. Consequently, growth for regionals will come via consolidation or higher risk (non-fixed fee, contractual flying).’”

⁷² See “Delta Fleet Deal Drops Close to 200 50-Seaters To Gain Larger RJs,” *Aviation Daily*, May 25, 2012. See also “Comair to Cease Operation,” Delta Press Release, July 27, 2012.

**EXHIBIT 17: ANNUAL 50-SEAT AND SMALLER RJ BLOCK HOURS, 1998-FYE
2012Q3**



Source: OAG.

Notes: Large Network Carriers are Delta (including Northwest), United (including Continental), US Airways (including America West), and American (including TWA).

52. The decline in demand for regional carrier services combined with intense pressure on the large network carriers to reduce costs in response to fierce price competition and rising fuel prices has taken a heavy toll on both the wholly-owned and independent regional carriers. Several once-prominent regional carriers, including Comair, Mesa and American Eagle have sought (or are currently seeking) to restructure under Chapter 11, and some regional carriers including Comair, Atlantic Coast, Air Midwest and Big Sky have (or are in the process of being) liquidated.⁷³ Likewise, Republic, whose regional carrier operations have been consistently profitable since 2002, has also recently stated that it would even consider restructuring its Chautauqua subsidiary in bankruptcy to achieve the \$40-

⁷³ Sources: Airlines for America, U.S. Airline Bankruptcies and Service Cessations, <http://www.airlines.org/Pages/U.S.-Airline-Bankruptcies-and-Service-Cessations.aspx> and "Comair to Cease Operation," Delta Press Release, July 27, 2012.

\$60 million in annual cost savings required to return its 50-seat RJ operations to profitability.⁷⁴

53. Moreover, even SkyWest, the largest—and, historically, one of the most successful— independent regional carriers has not been immune from the recent challenges facing the regional airline industry. For example, in 2011 SkyWest’s pre-tax margin excluding special charges was -1.4% (its first annual loss in 23 years).⁷⁵ Furthermore, SkyWest’s management has acknowledged that it needs to achieve cost savings in order to remain competitive.⁷⁶
54. As demonstrated in Exhibit 18 below, the challenging conditions for regional carriers have resulted in industry-wide operating margins in 2011 falling to their lowest level in a decade.⁷⁷

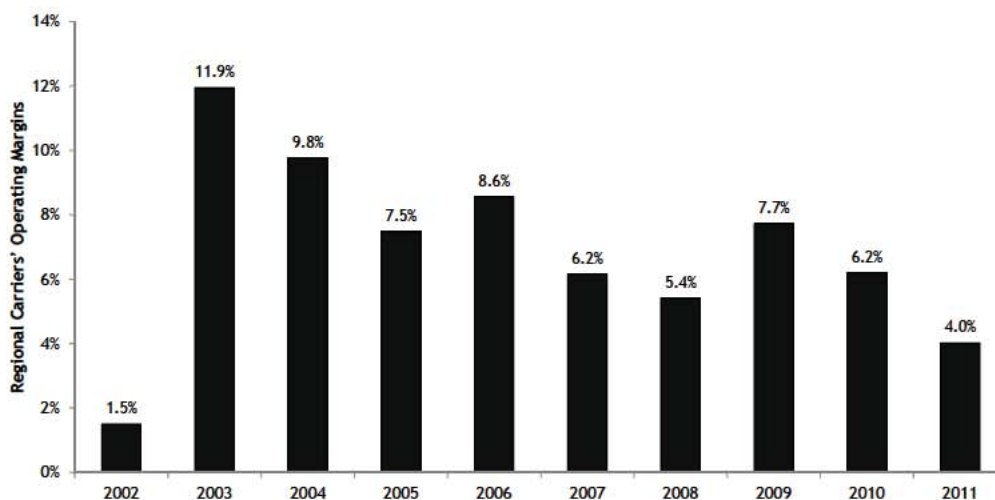
⁷⁴ Source: “Republic Says Troubled Chautauqua Could be Split From Holding Company,” *Aviation Daily*, May 2, 2012.

⁷⁵ See “Utah’s SkyWest Posts First Annual Loss Since 1988,” *The Salt Lake Tribune*, February 16, 2012, and SkyWest SEC 10K filings.

⁷⁶ For example, in a conference call with financial analysts discussing its 2011 earnings, SkyWest’s CEO Jerry Atkin stated “What I was suggesting is we admittedly have a gap in terms of our cost competitiveness at the ExpressJet operation. We will get some of it this year. It’ll take at least a second year and maybe a small part of the third year to get it to fully competitive costs.” Mr. Atkin further noted that “The challenge of getting control of ExpressJet also delayed cost reduction efforts at ASA. We experienced substantial contract rate reductions at ASA at the end of 2010 that affected all of 2011.” See “Q4 2011 SkyWest Earnings Conference Call-Final”, Dow Jones, February 16, 2012.

⁷⁷ See “Collapse of The U.S. Regional Airline Industry is a Real Concern”, Aviation Week Blog, February 14, 2012. <http://www.aviationweek.com/Blogs.aspx?plckBlogId=Blog:7a78f54e-b3dd-4fa6-ae6e-dff2ffd7bdbb&plckController=Blog&plckBlogPage=BlogViewPost&newspaperUserId=7a78f54e-b3dd-4fa6-ae6e-dff2ffd7bdbb&plckPostId=Blog:7a78f54e-b3dd-4fa6-ae6e-dff2ffd7bdbbPost:e472752e-b8d0-4dd5-86e8-2ab90e9fbed&plckScript=blogScript&plckElementId=blogDest>.

EXHIBIT 18: OPERATING MARGINS OF REGIONAL CARRIERS, 2002-2011



Sources: U.S. DOT Form 41

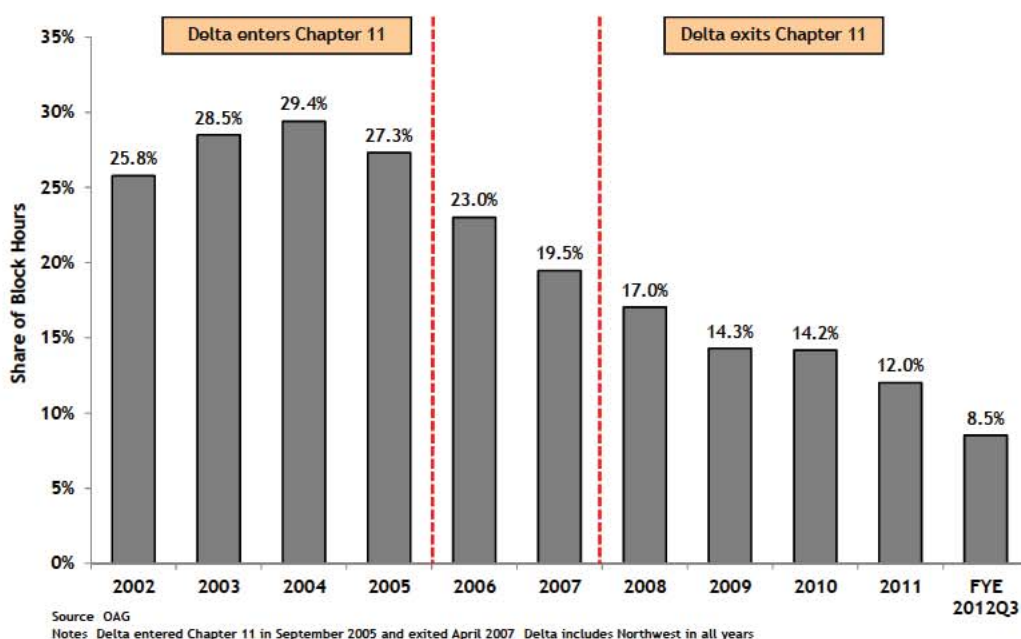
Notes: Regional Carriers include SkyWest, Air Wisconsin, Mesa Airlines, AMR Eagle, PSA/Piedmont, ExpressJet, ASA, Freedom, Pinnacle, Mesaba, Colgan, Republic, Shuttle America, Trans States, Compass Airlines and GoJet

55. Although the challenging environment has affected all regional carriers, those carriers with the highest cost structures have seen the most dramatic reduction in their share of flying for large network carriers. For example, as demonstrated by Exhibit 19, Comair's share of Delta's regional flying fell from 29.4% in 2004 (the year prior to Delta's bankruptcy) to only 8.5% in FYE 2012-Q3, as Delta shifted flying to regional carriers that were able to provide safe and reliable lift at costs lower than Comair could provide. Over the same period of time, Comair's rank among U.S. regional carriers (in terms of ASMs) fell from second to tenth.⁷⁸ In announcing that Comair would reduce its fleet by more than 50% in 2010, Comair's President stated that "Our need to change is significant, and the scope of change will be difficult but necessary. Our current cost structure...remains approximately 20% higher than our peers on a cost-per-block-hour basis [and]

⁷⁸ Source: OAG.

does not enable us to be competitive in the current industry environment.”⁷⁹ Comair’s President also wrote “To secure our future, we need to demonstrate our ability to operate as a standalone entity.... We must be able to earn a profit while reducing our operating costs to what the market is willing to pay for our services.”⁸⁰ However, as shown below in Exhibit 19, Comair’s high cost structure resulted in it being awarded less and less of Delta’s regional carrier lift over the past decade, further increasing its costs, and rendering Comair economically unviable. As a result, Comair will cease all operations at the end of September.⁸¹

EXHIBIT 19: COMAIR’S SHARE OF DELTA CONNECTION REGIONAL BLOCK HOURS



56. In sum, the dramatic changes that have adversely impacted the profitability of the large network carriers over the past decade have “spilled over” into the market for regional air services, and regional carriers are now faced with the prospect of

⁷⁹ See “Delta’s Comair announces major downsizing,” *Air Transport World*, September 2, 2010.

⁸⁰ See “Comair Plans to Slash Fleet, Labor Costs,” *Aviation Week*, September 2, 2010.

⁸¹ See “Comair to Cease Operation,” Delta Press Release, July 27, 2012.

competing for flying opportunities at the four remaining large network carriers. Unless Pinnacle is able to lower its costs to the level where it can earn a profit margin on its remaining contracts with Delta sufficient to reinvest in the Company, it risks shrinking further or even being forced out of business entirely.

IV. OVERVIEW OF PINNACLE AND ITS COMPETITORS

(i) Pinnacle

57. Pinnacle Airlines was founded in 1985 as Express Airlines I to provide regional lift to Republic Airlines (which was acquired by Northwest in 1986).⁸² On April 1, 1997, Pinnacle was acquired by Northwest Airlines Corporation.⁸³ In 2003 Pinnacle was spun-off from Northwest through an initial public offering but continued to operate as a Northwest Airlink partner through a multi-year Airline Services Agreement with Northwest.⁸⁴ Pinnacle acquired Colgan Airlines in January 2007 and Mesaba Airlines in July 2010.⁸⁵ For the full year ending 2012-Q3, Pinnacle was the fourth largest U.S. regional carrier after SkyWest, American Eagle and Republic in terms of available seat miles.⁸⁶
58. Pinnacle operates a fleet of 181 aircraft (all of them RJs), consisting of 140 50-seat Bombardier CRJ-200 and 41 76-seat Bombardier CRJ-900s.⁸⁷ These aircraft are

⁸² Source: Pinnacle SEC S-1 filing, February 25, 2002, pages 4 and 38.

⁸³ Ibid.

⁸⁴ Source: Pinnacle Airlines 2003 Annual Report, pages 3 and 40.

⁸⁵ Source: Pinnacle 2007 SEC 10K report, page 1, and Pinnacle 2010 SEC 10K report, page 19.

⁸⁶ Source: OAG.

⁸⁷ Source: Pinnacle 8-K, August 17, 2012. Pinnacle also currently operates 16 additional CRJ-900 aircraft scheduled to be wound down and removed from their fleet in the first half of 2013. See Declaration Of John Spanjers In Support Of Pinnacle Airlines Corp.'s Motion To Reject Collective Bargaining Agreements With The Air Line Pilots Association, International, and The Association of Flight Attendants-CWA, Pursuant To 11 U.S.C. § 1113, September 13, 2012 (hereafter "Second Spanjers Declaration"), paragraph 9.

operated as Delta Connection flights on behalf of Delta Air Lines, principally providing short- and medium-haul flights to and from Delta's hub airports in Atlanta, Detroit, Memphis, New York City (John F. Kennedy) and Minneapolis/St. Paul.⁸⁸

59. Until recently, Pinnacle's Colgan subsidiary also operated 55 turboprops (a combination of 74-seat Bombardier Q-400s and 34-seat Saab 340s).⁸⁹ Colgan's sub-fleet of Q-400 turboprops operated as United Express flights on behalf of United Airlines, primarily on routes to/from United's hubs in Newark, Washington-Dulles and Houston.⁹⁰ Colgan's sub-fleet of Saab 340 turboprops operated as United Express flights on routes to/from United's hubs in Houston and Washington-Dulles and as US Airways Express flights on EAS routes throughout the Northeast.⁹¹
60. In addition to flight operations, Pinnacle formerly offered ground handling services (e.g., loading and unloading of checked bags, etc.) at several airports both for flights it operates on behalf of its mainline partners as well as for other airlines. As part of its restructuring, however, Pinnacle terminated all of its ground handling operations.⁹²
61. As described above, a combination of factors, including fierce competition among regional carriers for a shrinking set of regional flying opportunities from fewer

⁸⁸ Source: OAG, July 2012.

⁸⁹ Source: "Pinnacle Airlines Debtor-in-Possession Financing Approved", May 16, 2012. Colgan's turboprop operations were wound down as of September 5, 2012. See Pinnacle 8-K, July 9, 2012 (Letter from John Spanjers to All employees): "United asked us to adjust that schedule and wind down all operations by September 5, 2012 and we agreed."

⁹⁰ Source: OAG, July 2012.

⁹¹ Sources: OAG 2012 and First Spanjers Declaration, paragraph 8. See also Pinnacle 8-K, July 9, 2012 (Letter from John Spanjers to All employees).

⁹² See Second Spanjers Declaration, paragraph 9.

large network carriers and higher costs and operational difficulties related to the Company's pilots seniority integration, resulted in Pinnacle losing over \$30 million in 2011. Likewise, Pinnacle's net margin in 2011 of -2.4% was the lowest the Company had experienced since 1998 (the year Northwest Airlines suffered from a two-week strike).⁹³

(ii) Pinnacle's Competitors

62. Pinnacle competes with a number of other regional carriers, many of which—like Pinnacle—are independent (e.g., Republic, SkyWest, Trans States, etc.) and others of which are wholly-owned (e.g., American Eagle).
63. As part of its restructuring, Pinnacle has already wound down its turboprop operations on behalf of United and US Airways, leaving Delta as the only remaining customer for its services.⁹⁴ However, Delta currently procures its regional lift needs from both Pinnacle and a variety of other regional carriers (i.e., the Delta Connection carriers) and, as such, it is essential that Pinnacle is able to restructure its costs so as to be competitive with these other carriers. In addition to Pinnacle, which accounted for 29.7% of Delta Connection capacity for the full year ending September 30, 2012, the Delta Connection carriers currently include:⁹⁵
- SkyWest (and its subsidiary ExpressJet), which operate (as Delta Connection) a fleet of 50-seat CRJ-200s, 65-seat CRJ-700s, 76-seat CRJ-900s and 30-seat Embraer 120 turboprops. For the year ending September 30, 2012, SkyWest

⁹³ Sources: <http://www.nmb.gov/publicinfo/airline-strikes.html>, Pinnacle Airlines Form S-1, and 10-Ks.

⁹⁴ See First Spanjers Declaration, paragraph 8. See also Pinnacle 8-k, July 9, 2012 (Letter from John Spanjers to All employees): "United asked us to adjust that schedule and wind down all operations by September 5, 2012 and we agreed."

⁹⁵ Source: http://www.delta.com/planning_reservations/plan_flight/aircraft_types_layout/index.jsp, http://www.delta.com/planning_reservations/plan_flight/flight_partners/delta_connection_carriers/index.jsp and OAG.

and ExpressJet accounted for approximately 39.6% of Delta Connection capacity.

- Republic, which, through its Chautauqua and Shuttle America subsidiaries, operates (as Delta Connection) a fleet of 50-seat ERJ-145s, 69-seat E-170s and 76-seat E-175s. For the full year ending September 30, 2012, Chautauqua and Shuttle America accounted for approximately 9.3% of Delta Connection capacity.
- Trans States Holding, which, through its GoJet and Compass Airlines subsidiaries, operates a fleet of 65-seat CRJ-700s, 69-seat E-170s and 76-seat E-175s. For the full year ending September 30, 2012, GoJet and Compass Airlines accounted for approximately 13.3% of Delta Connection capacity.
- Comair, a wholly-owned subsidiary of Delta which operates a fleet of 50-seat CRJ-200s, 65-seat CRJ-700s and 76-seat CRJ-900 regional jets. For the full year ending September 30, 2012, Comair accounted for approximately 8.1% of Delta Connection capacity. As noted above, however, Delta will be shutting down Comair at the end of September.

64. In order for Pinnacle to expand its customer base beyond Delta, it must achieve a cost structure that would enable it to compete with other independent, non-Delta Connection carriers. These carriers include:

- Mesa, an independent regional carrier that currently operates a fleet of 37-seat Dash-8 turboprops, 50-seat CRJ-200, 66-seat CRJ-700 and 79-seat CRJ-900s on behalf of US Airways and United Airlines.⁹⁶

⁹⁶ As recently as 2010, Mesa subsidiary Freedom Airlines operated as a Delta Connection carrier. *Sources:* OAG and U.S. DOT T100 database.

- Air Wisconsin, an independent regional carrier that operates a fleet of 50-seat CRJ-200s on behalf of US Airways.
- American Eagle and Executive Airlines, wholly owned subsidiaries of AMR Corporation (the parent of American Airlines), which collectively operate a fleet of 63-seat CRJ-700s, 37 to 50-seat ERJ-135/140/145s and 64 to 66 seat ATR-72 turboprop aircraft. Like Pinnacle, AMR Eagle is currently restructuring under Chapter 11.

V. IN ORDER TO REMAIN VIABLE IN THE INCREASINGLY COMPETITIVE REGIONAL AIRLINE INDUSTRY, PINNACLE MUST REDUCE ITS LABOR COSTS

(i) Labor Represents—By a Wide Margin—Pinnacle’s Single Largest Controllable Cost

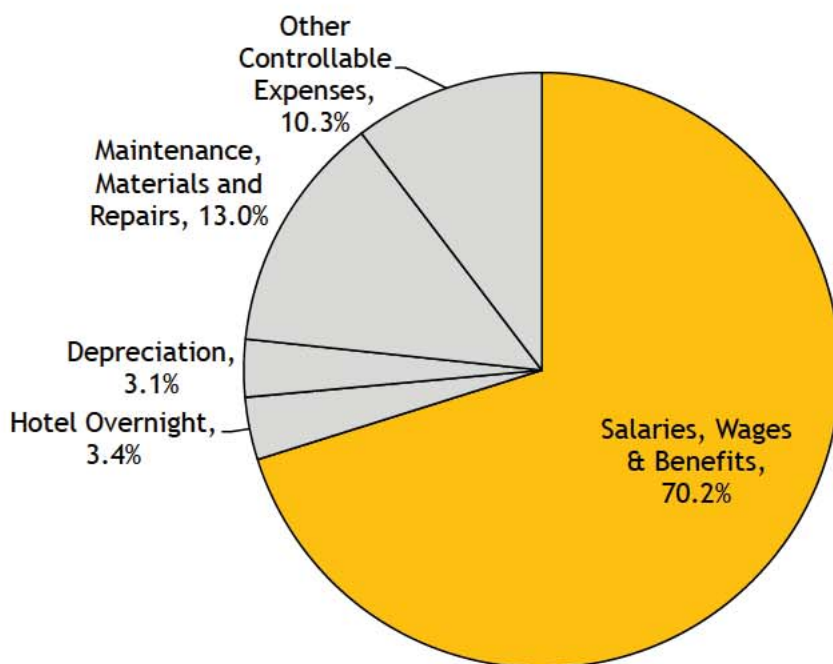
65. Given the highly commoditized nature of the market for regional lift procured under CPAs and the small handful of large network carriers procuring such services, it is critical for a regional carrier to have a low cost structure—and in particular, a low labor cost structure—in order to remain viable. Indeed, aside from safety and operational reliability, a competitive labor cost structure is likely to be the most important determinant of a regional carrier’s long term viability. This is because under a capacity purchase agreement, labor accounts for the bulk of a regional carrier’s controllable (i.e., non-pass through) costs. Moreover, unlike mainline carriers, regional carriers have far less control over other aspects of their operations, network, product and cost structure than do mainline carriers,⁹⁷ and thus, can do little outside of keeping their labor and other administrative costs in check in order to be able to offer large network carriers competitive rates while

⁹⁷ For example, since the mainline partner dictates the aircraft, seating configuration, routes and flight schedules of its regional partners, a regional carrier is largely unable to gain a cost advantage over another regional carrier through higher aircraft utilization, greater seating density, or by flying to secondary, lower cost airports.

also earning a profit margin sufficient to warrant continued investment in the business.

66. As shown in Exhibit 20, labor represents—by a wide margin—the single largest non-pass through expense for Pinnacle, accounting for 70% of its forecasted controllable operating expenses in 2013.⁹⁸

EXHIBIT 20: PINNACLE'S CONTROLLABLE COSTS (2013 FORECAST)



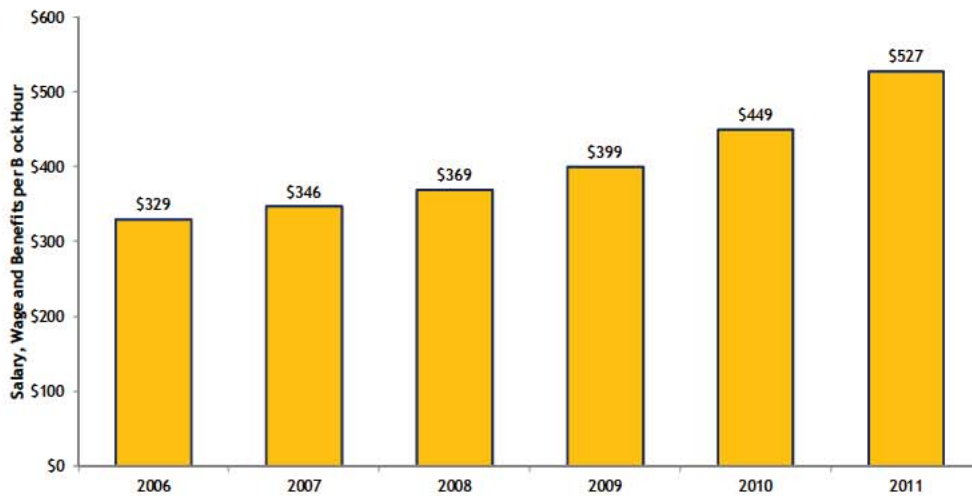
Source: 2.10 All Contracts 2013+ LRO PNCL P&L (8.16.2012)_Dataroom.CONFIDENTIAL.xlsx; 2.7 120816 - Pinnacle - Labor cost savings summary vfinal (for data room) (2).pdf.

Note: Salaries, Wages, and Benefits do not reflect the \$76 million reduction contained in 2.7 120816 - Pinnacle - Labor cost savings summary vfinal (for data room) (2).pdf. Impairment & Return and Integration Costs are excluded.

⁹⁸ Because Pinnacle currently operates both capacity purchase and pro-rate agreements, Exhibit 20 relies on the Company's forecast of their controllable costs for 2013 (i.e., after the draw-down of their pro-rate agreements).

67. Moreover, as shown in Exhibit 21, Pinnacle's labor costs per block hour have risen by more than 60% over the past six years.

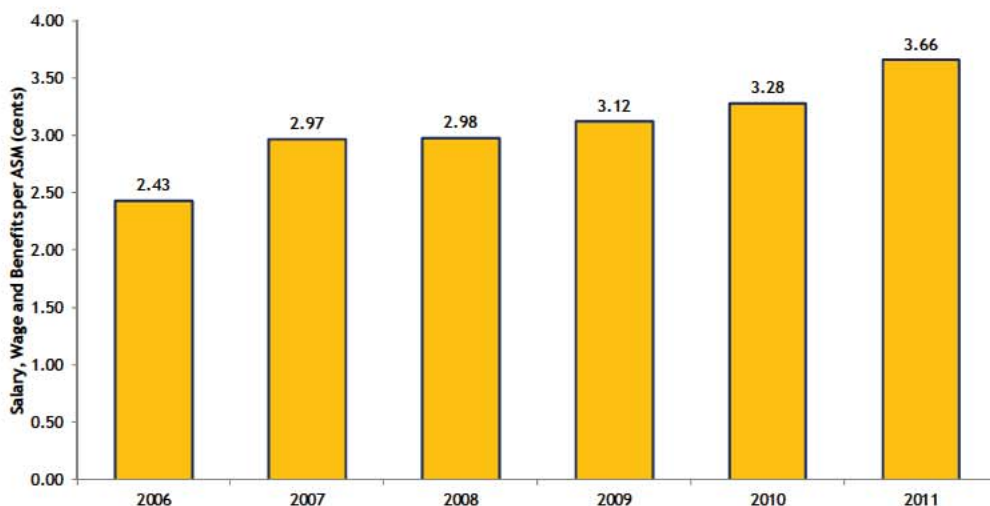
EXHIBIT 21: PINNACLE'S LABOR COSTS PER BLOCK HOUR, 2006-2011



Sources: Pinnacle SEC 2010 10-K filing; 2011 figures from 2.2 All Contracts LRO Delta PNCL P&L (5/8/2012)_Dataram CONFIDENTIAL.xlsx

68. Similarly, Exhibit 22 shows that Pinnacle's labor costs per ASM have risen by more than 50% over the past six years.

EXHIBIT 22: PINNACLE'S LABOR COSTS PER ASM, 2006-2011



Sources: Pinnacle SEC 2010 10-K filing 2011 figures from 2.2 All Contracts LRO Delta PHCL P&L (5 8 2012)_Dataroom CONFIDENTIAL.xlsx

(ii) Over the Past Year, Pinnacle Has Dramatically Reduced Its Non-Union Labor and Other Overhead Costs

69. It is my understanding that since late 2011 Pinnacle has taken dramatic steps to reduce its non-union labor costs as well as other overhead costs. For example, Pinnacle substantially reduced its management and non-contract headcount, resulting in approximately \$13.5 million in annual savings. In addition, Pinnacle eliminated merit increases and cost of living increases in 2012 for non-contract employees, resulting in approximately \$3.3 million in annual savings.⁹⁹
70. Moreover, it is my understanding that Pinnacle has taken steps to reduce several other aspects of its overhead and administrative costs and that they have already identified approximately \$25.7 million of potential savings associated with its

⁹⁹ See Declaration Of Virginia L. Hughes In Support Of Debtors' Motion To Reject Collective Bargaining Agreements With The Air Line Pilots Association, International, and The Association of Flight Attendants, Pursuant To 11 U.S.C. § 1113, September 13, 2012 (hereafter "Declaration of Virginia Hughes"), paragraph 18.

materials cost, headquarters, non-union wages and headcount, and other items.¹⁰⁰ Finally, it is my understanding that the Company has completed or is in the process of winding down all of its unprofitable turbo-prop operations, as well as its ground operations in order to help restore the Company's viability.¹⁰¹

(iii)Pinnacle Faces Upward Pressure on Its Already High Labor Costs Because of Its Restructuring

71. In 2011, Pinnacle's unit labor costs were among the highest in the regional carrier industry. For example, as shown in Exhibit 23, Pinnacle's¹⁰² average pilot cost per pilot block hour¹⁰³ in 2011 for RJs with more than 50 seats was among the highest in the industry and more than 30% higher than the average of the Delta Connection carriers with the exception of Comair (which Delta is in the process of shutting down because of its high cost structure).¹⁰⁴ Also notable is the fact that Pinnacle's pilot costs per block hour were approximately 70% and 80% higher than Delta Connection carriers Compass and GoJet, respectively. Moreover, American Eagle is seeking \$43.1 million in annualized cost savings from its pilots, which would substantially reduce its hourly pilot costs.¹⁰⁵

¹⁰⁰ See Declaration of Virginia Hughes, paragraph 20.

¹⁰¹ See Second Spanjers Declaration, paragraph 9 and Declaration of Virginia Hughes, paragraph 18.

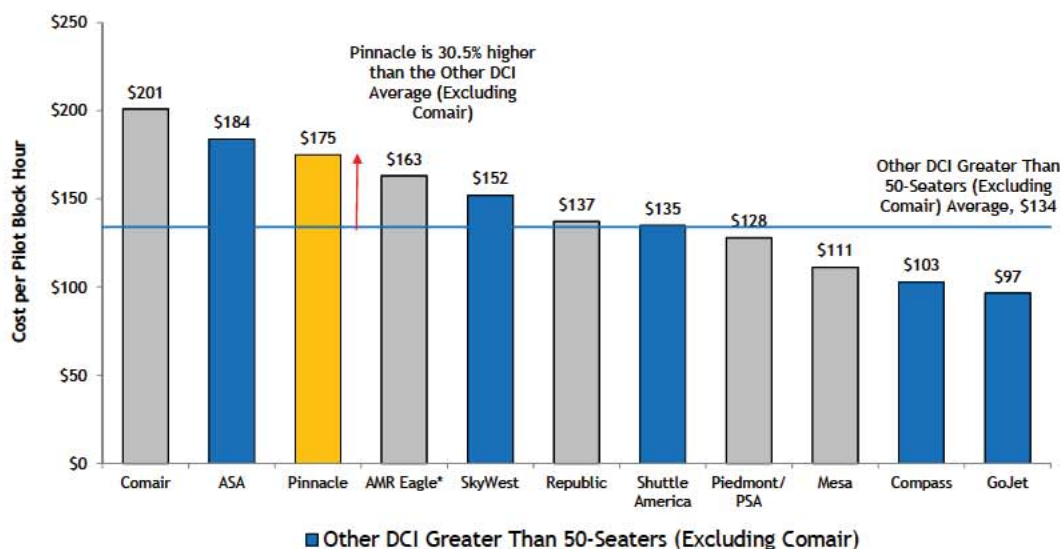
¹⁰² Pinnacle and Mesaba, which are reported separately in the DOT Form 41 database, are combined for all of the Form 41 analysis in this report and referred to as Pinnacle.

¹⁰³ For regional airlines, each aircraft block hour results in two pilot block hours (i.e., one captain and one first officer).

¹⁰⁴ Source: U.S. DOT Form 41. ASA's high cost per pilot block rate of \$184 is the result of unusually high reported costs for its CRJ-700 of \$194.80. For its CRJ-900s, ASA's pilot cost per block hour is \$137.50, comparable to SkyWest's costs. Using this rate for ASA results in an average for the DCI carriers excluding Comair of \$122.14 and based on this average, Pinnacle was 43.3% higher than average of the other DCI carriers excluding Comair in 2011.

¹⁰⁵ Source: <http://www.restructuringamr.com/ae-our-people-alpa.asp>. It is my understanding that AMR Eagle has reached tentative agreements with its pilots which—if ratified—could result in a slightly

EXHIBIT 23: PILOT COSTS PER PILOT BLOCK HOUR FOR RJs WITH MORE THAN 50 SEATS, 2011



*AMR Eagle excludes targeted savings from its Chapter 11 restructuring
Sources U S DOT Form 41

Notes Pilot costs include salaries, benefits, payroll taxes, and personnel expenses for pilots, co-pilots, trainees, and instructors Greater Than 50-Seaters includes CRJ-700, CRJ-900, E-170, and E-175 Pinnacle includes Pinnacle and Mesaba AMR Eagle includes American Eagle and Executive

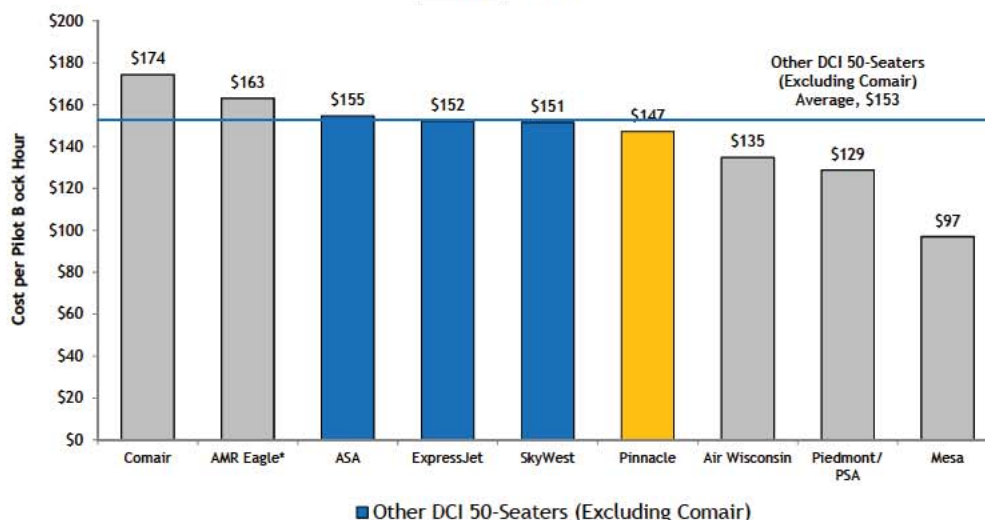
72. Likewise, while Exhibit 24 shows that Pinnacle's current average pilot cost per pilot block hour for RJs with 50 or fewer seats is middle of the pack, the 2011 figures *exclude* the substantial upward cost pressure that will be put on Pinnacle's pilot costs as a result of the shrinking of its fleet (i.e., removal of the 16 CRJ-900s and all of its turboprops) and the subsequent integration of its pilot seniority list.¹⁰⁶ For example, I estimate that the reduction by approximately [REDACTED] pilots resulting from the shrinkage in the Company's fleet will increase the average seniority of

different actual cost savings. See "American Eagle and its pilots reach a tentative agreement," Dallasnews.com, August 8, 2012.

¹⁰⁶ Republic subsidiary Chautauqua, which operates 50-seat RJs for Delta Connection, does not report its aircraft-specific pilot costs in Form 41. Moreover, while SkyWest subsidiaries SkyWest Airlines and ExpressJet/ASA have marginally higher reported pilot costs per block hour than Pinnacle for 50-seat RJs, those carriers enjoy other cost advantages as a result of SkyWest's larger scale and deeper financial resources. See footnote 126 below.

Pinnacle's captains by approximately [REDACTED] years, placing upward pressure on Pinnacle's pilot costs.¹⁰⁷

EXHIBIT 24: PILOT COSTS PER PILOT BLOCK HOUR FOR RJs WITH 50 OR FEWER SEATS, 2011



*AMR Eagle excludes targeted savings from its Chapter 11 restructuring

Sources U S DOT Form 41

Notes Pilot costs include salaries, benefits, payroll taxes, and personnel expenses for pilots, co-pilots, trainees, and instructors. 50-seaters includes regional jets with 50 or less seats and includes CRJ-100, CRJ-200, ERJ-135, ERJ-145 and ERJ-140. Pinnacle includes Pinnacle and Mesaba. AMR Eagle includes American Eagle and Executive.

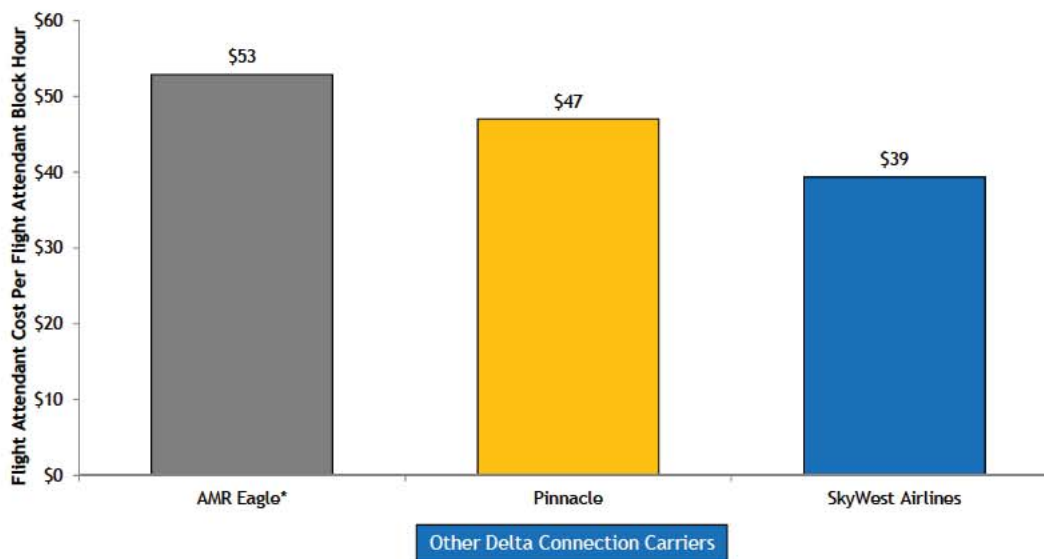
73. Moreover, Exhibit 25 compares Pinnacle's average flight attendant costs per flight attendant block hour to those regional carriers that reported flight attendant costs in the U.S. DOT Form 41 data in 2011. Exhibit 25 shows that Pinnacle's average flight attendant costs per flight attendant block hour are nearly a third higher than those of SkyWest, the largest regional carrier and largest Delta Connection carrier.¹⁰⁸ And although American Eagle's current flight attendant costs per block

¹⁰⁷ Sources: Analysis of 6.46 120817 Data & Assumptions for ALPA.CONFIDENTIAL.xlsx and 6.0 Pilots - Other\6.44 120816 Buildup of PNCL cost disadvantage (for data room).xlsx. Assumes that [REDACTED] fewer pilots will be needed because of the removal of the 16 ATL CRJ-900s and [REDACTED] because of the removal of all turbo props. I assume that pilots are removed by reverse seniority.

¹⁰⁸ Flight attendant block hours are computed based on the number of regional aircraft block hours flown by seating configuration, since FAA regulations require a minimum of one flight attendant per 50 seats (see

hour are higher than Pinnacle's, American Eagle is seeking \$9.2 million in annualized cost savings from its flight attendants.¹⁰⁹

EXHIBIT 25: FLIGHT ATTENDANT COSTS PER FLIGHT ATTENDANT BLOCK HOUR, 2011



*AMR Eagle excludes targeted savings from its Chapter 11 restructuring.

Sources: U.S. DOT Form 41; 2.2 All Contracts LRO Delta PNCL P&L (5.8.2012)_Dataroom.CONFIDENTIAL.xlsx.

Notes: Flight attendant block hours estimated based on FAA minimum staffing requirements of one flight attendant per 50 seats. AMR Eagle includes Executive; Pinnacle includes Pinnacle, Mesaba, and Colgan; SkyWest includes ExpressJet, and ASA. AMR Eagle and SkyWest flight attendant costs are "Flight Attendant Expenses" from Form 41 and includes salaries and related employee benefits, pensions, payroll taxes and personnel expenses. Pinnacle flight attendant cost from "2.2 All Contracts LRO Delta PNCL P&L (5.8.2012)_Dataroom.CONFIDENTIAL.xlsx" and includes salary, wages and benefits.

74. Pinnacle's high labor costs are the result of several factors, including a more senior workforce than many of its competitors, restrictive work rules that limit the productivity of its employees and more costly benefits than its competitors.¹¹⁰

14 CFR Part 121 Section 391). Thus, each 50-seat RJ block hour generates one flight attendant block hour, while each 70-seat RJ block hour generates two flight attendant block hours.

¹⁰⁹ Source: <http://www.restructuringamr.com/ae-our-people-afa.asp> and U.S. DOT Form 41. It is my understanding that AMR Eagle has a ratified a tentative agreement with its flight attendants which may have slightly different actual cost savings. See "Flight Attendants at American Eagle Ratify Bankruptcy Agreement", AFA Press Release, September 7, 2012.

75. Because most airline employees (excluding management) are paid an hourly rate based on their years of service, a carrier with high average seniority (like Pinnacle) can have substantially higher overall labor costs even if its hourly rates (“pay scales”) are comparable with those of other regional carriers. Pinnacle’s high seniority results from several factors, including the fact that Pinnacle itself is the product of the merger of two “legacy” regional carriers (Mesaba and Pinnacle) whose employees brought their accrued seniority with them when they became part of Pinnacle and a lack of growth (and thus hiring) by mainline airlines who had previously hired experienced pilots from the regionals.¹¹¹
76. Even before the drawdown of its turboprop flying and pending removal of certain CRJ-900 flying, Pinnacle’s pilot seniority was higher than that of other independent regionals (e.g., Republic, Compass, and GoJet).¹¹² However, because furloughs are taken off the bottom of the seniority list (i.e., impact the most junior, and thus, lowest paid employees), the elimination of Pinnacle’s turboprop flying, in addition to the reduction of its CRJ-900 flying for Delta, will further exacerbate Pinnacle’s seniority disadvantage. As an example of Pinnacle’s seniority disadvantage vis-à-vis other independent regional carriers, Exhibit 26 compares the post-drawdown seniority distribution for Pinnacle¹¹³ to the estimated

¹¹⁰ See Declaration of Jerry Glass.

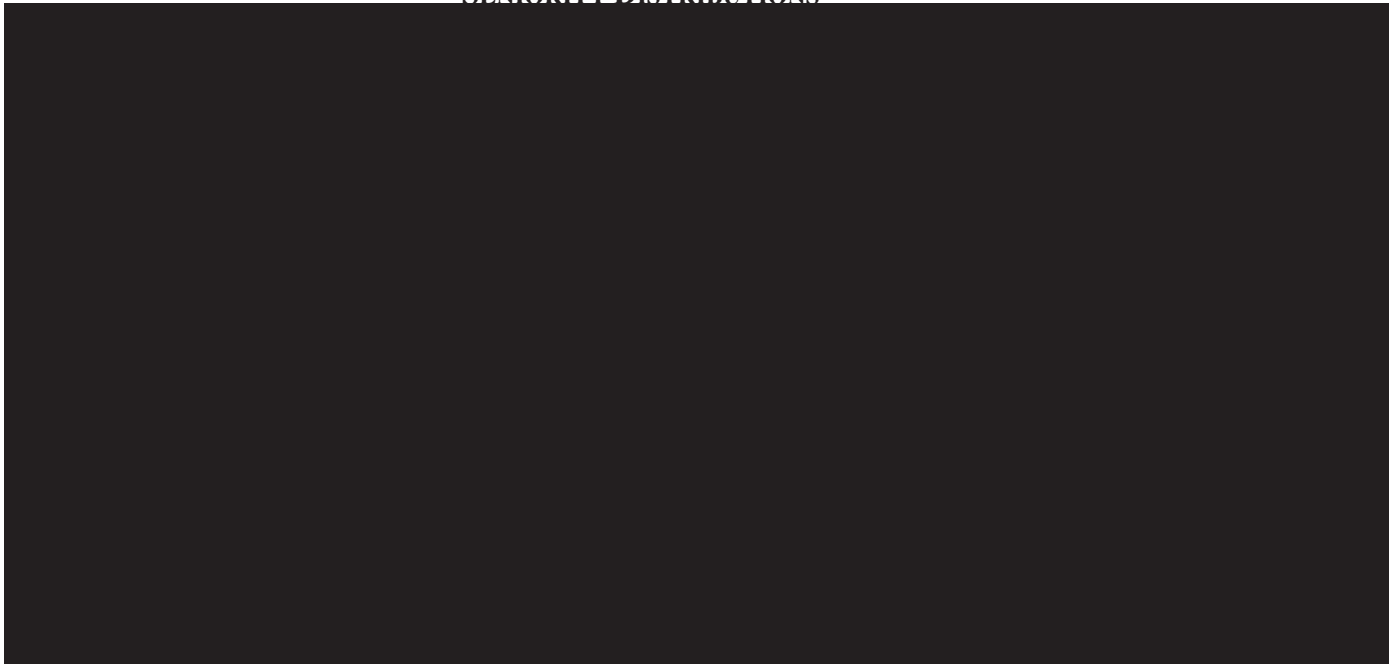
¹¹¹ In addition to high average seniority of many former Mesaba and Pinnacle pilots, several former Colgan pilots that will remain after the shutdown of the Company’s turboprop operations have extremely high seniority. For example, there are ■ former Colgan pilots with ■ or more years of service. Source: 4.20 ISLasof6MAY12.CONFIDENTIAL.

¹¹² Pinnacle’s relatively higher average seniority vis-à-vis other independent regionals such as Republic and SkyWest stems from the fact that the latter carriers grew far faster than Pinnacle when most RJs were being delivered between 1998 and 2008. For example, between 1998 and 2008, Pinnacle’s fleet grew only 86% (from 121 to 225) compared to 183% (from 96 to 272) for SkyWest and 536% (from 36 to 229) for Republic. Sources: *Annual Reports of the Regional Airline Association*, 1999 and 2008. Republic includes Chautauqua, Republic and Shuttle America; Pinnacle includes Express Airlines I, Pinnacle and Mesaba; SkyWest includes SkyWest Airlines.

¹¹³ The drawdown is only for the 16 CRJ-900s and turbo props. Although it is known the Delta plans to fly 200 fewer 50-seat RJs in the future (see “Delta Fleet Deal Drops Close to 200 50-Seaters To Gain Larger

distributions for Compass and GoJet captains.¹¹⁴ Exhibit 26 shows that after the drawdown, *all of Pinnacle's captains* will have seven or more years of service, and nearly a quarter of Pinnacle's captains will have 15 or more years of service. In contrast, the *most senior* captains for Compass and GoJet have six and eight years of seniority, respectively.¹¹⁵

**EXHIBIT 26: COMPARISON OF PINNACLE, COMPASS AND GOJET CAPTAIN
SENIORITY DISTRIBUTIONS**



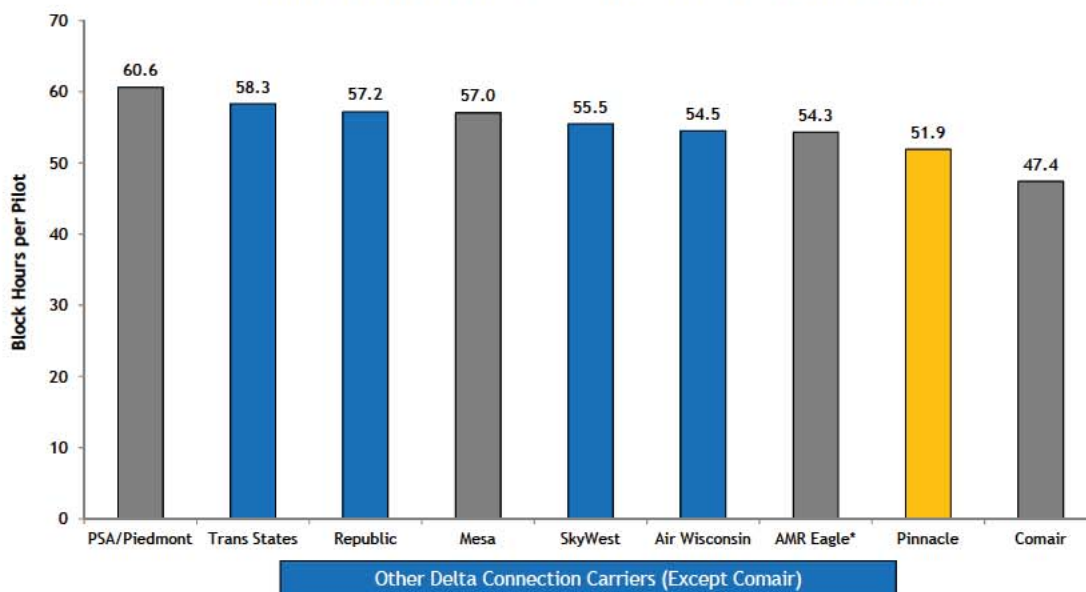
RJs", *Aviation Daily*, May 25, 2012.) no assumption was made as to how this will affect Pinnacle's fleet going forward.

¹¹⁴ The actual seniority lists for most carriers are not publicly available. However, because the timing of Compass and GoJet's fleet deliveries are publicly known, one can reasonably estimate their pilot seniority distributions by making assumptions regarding pilot-to-aircraft staffing ratios as well as attrition rates. For the purposes of Exhibit 26, I assumed an annual pilot attrition rate of 10% for Compass and GoJet and a staffing ratio of 10.5 pilots per aircraft. Moreover, because pilots and other workgroups (e.g., flight attendants) are typically added to an airline's roster in similar ratios as carriers grow, I believe that the comparison of pilot seniority distributions for Pinnacle versus Compass and GoJet's pilots would be typical of other workgroups for the two carriers. *See also* Appendix D.

¹¹⁵ Likewise, based on my analysis of Republic's pilot seniority list (which became public as part of a seniority integration arbitration award), I estimate that only 5% of that carrier's captains have 15 or more years of service, compared to █% for Pinnacle. *Source:* Arbitrator Eischen's Final Award in the Matter of Seniority List Integration Arbitration Under Allegheny-MOHAWK Labor Protective Provisions, Section 13(b), 11/9/2009.

77. Pinnacle's CBAs also contain several restrictions that limit the productivity of its workforce.¹¹⁶ These contract restrictions have resulted in Pinnacle's pilot and flight attendant productivity lagging behind that of other regional carriers. Exhibit 27 shows that Pinnacle had the second lowest pilot productivity (measured in terms of the number of block hours flown per pilot per month in 2011) among regional carriers.

EXHIBIT 27: MONTHLY BLOCK HOURS PER PILOT, 2011



*AMR Eagle excludes productivity improvements targeted under its Chapter 11 restructuring

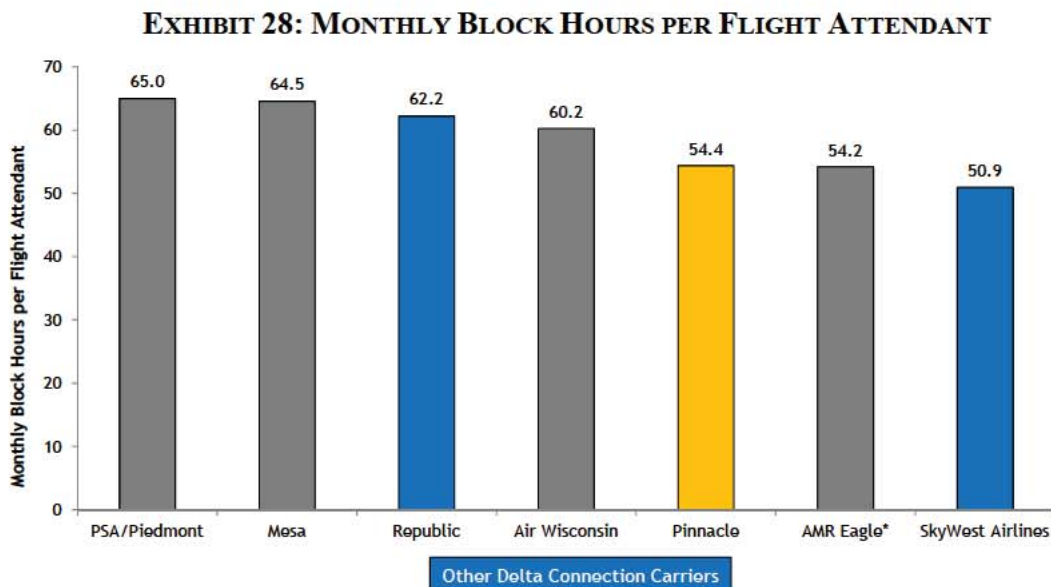
Sources: U.S. DOT Form 41; SEC 10-K filings

Notes: SkyWest includes SkyWest, ExpressJet, and ASA; Pinnacle includes Pinnacle and Mesaba; Republic is Shuttle America; Trans States includes Trans States, Compass Airlines and GoJet. Pilot headcount is from Form 41 except Comair is from Delta's SEC 10-K filing

78. Similarly, Exhibit 28 demonstrates that Pinnacle's flight attendant productivity (as measured by the average number of block hours flown per flight attendant in 2011) was also among the lowest in the regional carrier industry and far behind that of fast-growing independent competitors such as Republic. And even though

¹¹⁶ See Declaration of Jerry Glass.

SkyWest's flight attendants flew fewer hours than Pinnacle's in 2011, they have substantially lower costs per block hour, as demonstrated by Exhibit 25 above.



*AMR Eagle excludes productivity improvements targeted under its Chapter 11 restructuring

Sources: U.S. DOT Form 41; SEC 10K filings

Notes: SkyWest includes SkyWest, ExpressJet, and ASA; Pinnacle includes Pinnacle and Mesa; Republic includes Republic and Shuttle America. All data from Form 41 excepts SkyWest flight attendant headcount from 10K filing and Form 41. Flight Attendant block hours estimated based on one flight attendant per 50 seats.

79. Finally, Pinnacle's employee benefits are also more costly than those of the other regional carriers.¹¹⁷ These include a more generous 401k match, vacation accrual, payout of holiday pay without any incentive to work on holidays, etc.¹¹⁸

(iv) Without Substantial Labor Cost Savings, Pinnacle Will Be At a Significant Disadvantage in Competing For Additional Flying Opportunities from Delta or Another Large Network Carrier, Particularly For Large RJ Flying

80. Given the industry-wide reduction in 50-seat RJ flying that has already occurred and is almost certain to continue going forward, it is critical that Pinnacle achieve a

¹¹⁷ See Declaration of Jerry Glass.

¹¹⁸ See Declaration of Jerry Glass and Declaration of Virginia Hughes.

cost structure that will enable it to offer competitive rates for large RJ flying, such as for its CRJ-900 aircraft.¹¹⁹ Not only are large RJs far more fuel efficient on a per seat-mile or seat-hour basis than smaller (i.e., 50-seat or fewer) RJs, they are also large enough to be configured with First Class seating, thus enabling network carriers to generate additional revenue.¹²⁰ Thus, while Delta plans to eliminate approximately 200 50-seat RJs from its Delta Connection fleet, it also plans to *expand* its two-class large RJ fleet by 70 aircraft over the next several years.¹²¹ Similarly, American has indicated that a key component of its restructuring plan under Chapter 11 is to add substantially more dual-class large RJs,¹²² some of which will almost certainly be operated by independent regional carriers.¹²³

81. It is my understanding that Delta has already informed Pinnacle that the bids it has received from other regional carriers to perform large RJ flying are significantly below what Delta currently pays Pinnacle to operate the CRJ-900.¹²⁴ Based on my

¹¹⁹ As noted earlier, other current large RJs include the CRJ-700, E-170 and E-175.

¹²⁰ Currently, all 70-seat or larger RJs deployed by the large network carriers have First Class. See “US Airways Completes First Class Installation on Regional Jets,” *Flight Global*, January 9, 2012; http://www.delta.com/planning_reservations/plan_flight/aircraft_types_layout/index.jsp (Delta connection seat maps); <http://www.united.com/page/article/0,6867,50597,00.html> (United Express CRJ-700 seat map); and <http://www.united.com/page/article/0,6867,51212,00.html> (United Express E-170 seat map).

¹²¹ See “Delta to Take Delivery of Boeing 717 Aircraft Upon Ratification of Pilot Tentative Agreement,” Delta Air Lines Press Release, May 22, 2012.

¹²² See, for example, Memorandum of Decision, In re: AMR Corporation, *et al.*, United States Bankruptcy Court, Southern District of New York, August 15, 2012, Case No. 11-15463 (SHL) page 64: “The Court finds that the information in the Business Plan on regional jets is in line with American’s regional jet “ask” in the March 21 Proposal, which caps the number of aircraft at the 51 to 88 seat range at the larger of 255 or 50% of the total number of mainline aircraft in use at the time. The request for 255 regional aircraft is very much in line with the projected need in the Business Plan of [redacted].”

¹²³ See, for example, “Letter from Don Garton to American Eagle and Executive Employees,” March 21, 2012: “As we all know, American has expressed the desire to diversify this feed among several regional carriers. While Eagle will certainly seek to compete for American’s business, we fully expect that other competitors will be awarded some of this future flying.”

¹²⁴ See, Pinnacle Form 8-K, August 17, 2012 (Letter to All Employees): “Second, the bids Delta has received from other regional carriers for 76-seat jet flying were significantly below what they pay for Pinnacle’s CRJ-900 flying. Not surprisingly, those other airlines are some of the newer entrants in the industry, or carriers that have managed to grow in recent years (allowing them to maintain their cost

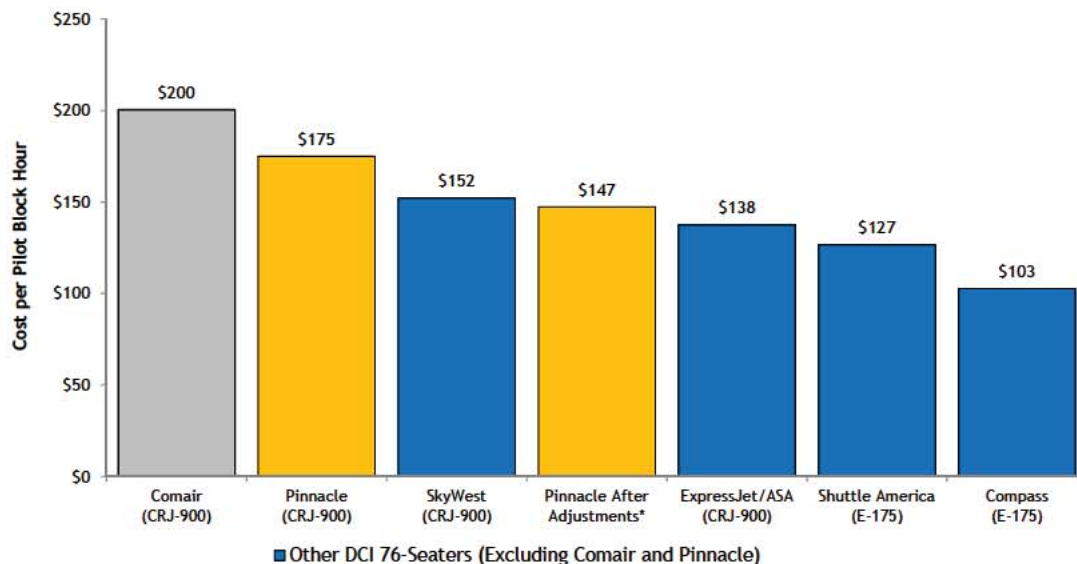
analysis of publicly available data, I have confirmed Pinnacle's pilot costs are substantially higher than many of Pinnacle's most likely competitors for Delta's 76-seat flying. For example, as demonstrated in Exhibit 29, Pinnacle's pilot costs per block hour were the highest among all DCI 76-seat RJ operators (excluding Comair). Moreover, even after applying the cost savings of -18.3% under the Company's May 18th term sheet and the subsequent increase in wage-related pilots costs resulting from the return of the 16 Pinnacle CRJ-900s (which I estimate to be +3.1%),¹²⁵ the Company's costs per pilot block hour for 76-seat flying would still exceed those of every other DCI carrier with the exception of SkyWest.¹²⁶

structures by spreading expenses over more aircraft)." *See also* Spanjers Second Declaration, paragraph 19.

¹²⁵ This estimate is based on an increase in average seniority of approximately [REDACTED] years (from [REDACTED] to [REDACTED] years) for the Company's CRJ-900 captains and an increase of approximately [REDACTED] years (from [REDACTED] to [REDACTED] years) for the Company's CRJ-900 first officers attributable to a reduction of [REDACTED] pilots resulting from the return of the 16 Pinnacle CRJ-900s. *See* 6.44 120816 Buildup of PNCL cost disadvantage (for data room).xlsx and Appendix C.

¹²⁶ Even though SkyWest's CRJ-900 pilot costs per block hour are marginally higher than Pinnacle's after the May 18th Term Sheet Savings, SkyWest has numerous other advantages not available to Pinnacle that have enabled it to successfully compete for flying opportunities with Delta and other mainline carriers. For example, SkyWest's large fleet size (numbering 725 aircraft) allows it to have lower unit overhead costs by spreading its overhead over a substantially larger revenue base than any other regional carrier. Likewise, unlike Pinnacle, SkyWest enjoys a substantial liquidity cushion (\$629.5 million in cash and marketable securities as of June 30, 2012) that enables it to better withstand industry fluctuations, invest in next generation aircraft such as the Mitsubishi MRJ and—at least in the short term—absorb lower profit margins to secure new contracts. Finally, unlike Pinnacle, both SkyWest and Republic own or lease the majority of their aircraft, which provides additional value to mainline carriers because it enables them to source regional lift without bearing any aircraft ownership risks. *See* "SkyWest Inc. Announces Second Quarter 2012 Results," SkyWest Press Release, August 8, 2012, SkyWest and Republic Holdings 2011 Form 10-K and "Mitsubishi Aircraft and SkyWest, Inc. Announce 100 Aircraft Agreement in Principle," Mitsubishi Aircraft Corporation Press Release, July 11, 2012.

EXHIBIT 29: DELTA CONNECTION 76-SEAT RJ COST PER PILOT BLOCK HOUR, 2011



Sources: U.S. DOT Form 41; http://www.delta.com/planning_reservations/plan_flight/flight_partners/delta_connection_carriers/index.jsp; http://www.delta.com/planning_reservations/plan_flight/aircraft_types_layout/index.jsp; 6.28 RJ900 Data CONFIDENTIAL.xlsx; 2.5.120518 - Pinnacle - Labor cost savings summary.pdf; 6.44.120816 Buildup of PNCL cost disadvantage (for data room).xlsx; *Adjustments include May 18th Term Sheet Savings (-18.3% based on 2.5.120518 - Pinnacle - Labor cost savings summary.pdf) and a seniority penalty of 3.1% to take account of the removal of the 16 ATL CRJ-900s. Excludes additional seniority related costs Pinnacle/Mesaba will incur starting in 2012 related to the integrated pilot seniority list.
Notes: Pilot costs include salaries, benefits, payroll taxes, and personnel expenses for pilots, co-pilots, trainees, and instructors.

82. Furthermore, it is my understanding that under the CPAs between Delta and both SkyWest and ExpressJet/ASA, Delta has the right to require that certain contractual rates (including those covering pilot costs) be no higher than the second lowest rate of all Delta Connection carriers.¹²⁷ Assuming that SkyWest and Express Jet's pilot costs per pilot block hour were equal to those of the second lowest DCI carrier (Shuttle America), I estimate that the Company's annual cost disadvantage *per aircraft* for 76-seat flying *solely attributable to pilot costs* after adjusting for the May 18th term sheet savings (-18.3%) and the added wage-related costs due to the return of the 16 former Pinnacle CRJ-900s (+3.1%) would be

¹²⁷ See SkyWest 2011 10-K, pages 9 and 10. See Declaration Of Virginia Hughes.

approximately \$309,000 higher than Compass and \$143,000 higher than Shuttle America, SkyWest and ExpressJet/ASA.¹²⁸

83. Although limitations in the Form 41 data do not allow me to compute a similar cost gap for flight attendants, I estimate that the Company's annual wage and wage-related disadvantage attributable to flight attendants per large RJ vis-à-vis Compass and GoJet is approximately [REDACTED] and [REDACTED] respectively.¹²⁹

(v) Without Substantial Labor Cost Savings, Pinnacle Will Also Be Unable to Achieve a Cost Structure That Enable It to Earn a Profit Sufficient to Attract Continued Investment

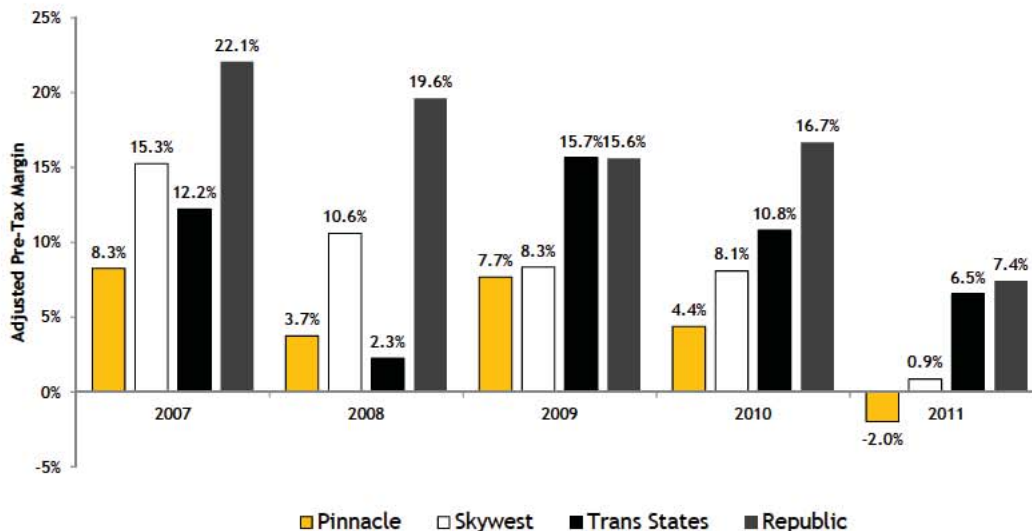
84. In sum, Pinnacle is now at the most critical crossroads in its more than 25 year history. Faced with a shrinking set of customers under intense competitive pressures to control their own costs, rising fuel prices that have made its regional aircraft less economic to operate, and a substantial reduction in the demand for short-haul trips, Pinnacle must adapt to the new competitive environment or risk a downward spiral of increasing losses, dwindling cash reserves and a potential liquidation.
85. Delta currently has several other carriers from which it can procure regional lift—most with costs that are substantially lower than Pinnacle's. Moreover, due their lower cost structures, these other independent Delta Connection carriers have been able to weather the turmoil currently re-shaping the regional airline industry far

¹²⁸ This calculation follows from the pilot costs per block hour figures in Exhibit 29 assuming two pilots per aircraft and 9.5 hours of aircraft utilization each day for an entire year. For example, Pinnacle annual CRJ-900 pilot costs would equal $\$147.35 \times 9.5 \times 365 \times 2 = \$1,021,891$ whereas Compass' annual E-175 pilot costs would equal $\$102.73 \times 9.5 \times 365 \times 2 = \$712,450$, for a difference of \$309,440. Compared to GoJet (which currently flies 65-seat CRJ-700s as a Delta Connection carrier), Pinnacle annual pilot cost disadvantage is \$352,103.

¹²⁹ Because Compass and GoJet are both relatively new carriers, I am able to estimate their flight attendant seniority distributions based on the timing of their aircraft deliveries by making use of a minimal number of assumptions. See Appendix D.

better than Pinnacle. For example, as shown in Exhibit 30, Pinnacle had the lowest adjusted pre-tax margin of all of the independent Delta Connection carriers in all but one of the last five years (2008).¹³⁰

EXHIBIT 30: ADJUSTED PRE-TAX MARGINS OF INDEPENDENT DELTA CONNECTION CARRIERS, 2007-2011



Sources: Carriers' SEC 10-K filings; U.S. DOT Form 41; Republic Airways Bank of America 2012 Global Transportation Conference presentation May 17, 2012; Republic Airways Investor Presentation, July 22, 2011.
Notes: Trans States is from U.S. DOT Form 41. Trans States includes Trans States in 2007, GoJet in 2007-2011, and Compass in 2007-2011. Republic data is for Fixed Fee segment only. Adjusted pre-tax margin is defined as pre-tax income (excluding non-reimbursed special charges) divided by revenues less expenses for aircraft fuel, aircraft and engine rental, depreciation and amortization, interest, and landing fees.

86. Thus, Pinnacle has little choice but to substantially reduce its costs in order to remain viable. And since labor costs under its Delta CPAs account for 70% of Pinnacle's controllable costs (see Exhibit 20 above), Pinnacle must achieve the labor cost savings it is seeking in order to lower its overall cost structure to a point where it can offer Delta competitive rates while at the same time earning a profit

¹³⁰ Because many components of a regional carrier's costs and revenues are in the form of "pass through" expenses, to compare profitability across different regional carriers on an "apples-to-apples" basis, it is important to remove the impact of these pass through expenses on profitability. Thus, for the purpose of this declaration, adjusted pre-tax margin is defined as pre-tax income (excluding non-reimbursed special charges) divided by revenues less expenses for aircraft fuel, aircraft and engine rental, depreciation and amortization, interest, and landing fees.

margin sufficient to attract new investment.¹³¹ Only if Pinnacle is able to reduce its costs to competitive levels, can it return to profitability and establish a viable platform for future growth.

VI. CONCLUSIONS

87. Pinnacle is at a critical juncture in its 25 plus year history. Faced with dwindling demand for 50-seat flying, fewer potential customers for its services, a more senior workforce than many of its peers and, consequently, labor costs for 76-seat flying that are the highest among the surviving Delta Connection carriers, Pinnacle must reduce its labor costs in order to remain viable.
88. Given the highly commoditized nature of regional lift, there is little reason to believe that Delta—or any other large network carrier for that matter—would elect to pay Pinnacle a premium over a host of other growing, lower cost regional carriers such as Compass, GoJet and Shuttle America for providing *the same* lift services. Simply put, absent labor cost savings, the Company faces a similar fate to that of other once prominent regional carriers including Comair and Atlantic Coast. These carriers failed to confront their rising cost structures, and, as a result, lost market share to lower cost competitors and were eventually were forced to liquidate.
89. If, on the other hand, Pinnacle can reduce its labor costs to the targeted levels, the Company will achieve a cost structure to compete effectively for new flying opportunities—including additional 76-seat flying for Delta—against lower cost regional carriers including Compass, Shuttle America and GoJet and establish a platform for viability and future growth.

¹³¹ As noted in Exhibit 7 and Exhibit 8 above, in 2011, Pinnacle had a net margin of -2.4% and incurred net losses of \$30 million.

Pursuant to 28 U.S.C. § 1746(2), I declare under penalty of perjury that the foregoing is true and correct.

Executed this 13th day of September, 2012, at Boston, Massachusetts

A handwritten signature in black ink, appearing to read "Daniel M. Kasper", written over a horizontal line.

Daniel M. Kasper
September 13, 2012

APPENDIX A: CURRICULUM VITAE OF DANIEL M. KASPER

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PROFESSIONAL EXPERIENCE:

Compass Lexecon, Boston, MA
Senior Consultant, March 2011-Present

PREVIOUS PROFESSIONAL EXPERIENCE:

November 1997-February 2011: *Managing Director & Head of the Transportation Practice*, Cambridge, MA Office, LECG (formerly, The Law & Economics Consulting Group)

Mr. Kasper was the founding director of LECG's Cambridge office and head of the firm's transportation practice. LECG was a leading provider of expertise to domestic and international clients in complex matters involving economics, finance and accounting. Mr. Kasper's practice focuses on economic, financial, labor, regulatory and competition policy issues in the transportation industries. Mr. Kasper's consulting clients have included most major U.S. airlines, several foreign airlines, the Air Transport Association, the American Association of Railroads, among others. In addition to consulting, Mr. Kasper is an experienced expert witness who has testified in numerous matters in the U.S. and Canada. His expert testimony includes matters before legislative bodies (U.S. and Canada), U.S. Executive Agencies (U.S. Department of Transportation, U.S. Department of Labor, National Mediation Board), Presidential Emergency Boards, arbitration panels, and courts in the United States and Canada on a range of transportation industry economic issues.

1993-1997: *Partner and Chairman, Transportation Industry Program,*
COOPERS & LYBRAND CONSULTING

Mr. Kasper joined Coopers & Lybrand in 1993 (when C&L acquired Harbridge House, Inc.). He headed C&L's Transportation Industry Program and directed a number of engagements involving domestic and international transportation clients in both the private and public sectors including major airlines, railroads (AMTRAK, the MBTA), airports, and turnpike authorities in Massachusetts and New Jersey. He also led a Congressionally-mandated review of the Federal Aviation Administration's performance and financial requirements.

1993: *Member,* UNITED STATES NATIONAL AIRLINE COMMISSION

In 1993, Mr. Kasper was appointed as one of fifteen voting members of the U.S. National Airline Commission, which was created by an act of Congress to assess the causes and potential cures for the economic troubles then plaguing the U.S. airline industry. After conducting extensive public hearings and analyses, the Commission submitted its Report and recommendations to the President and Congress in September of 1993. These recommendations included a number of proposed changes in Federal regulatory policy.

1983-1993: *Vice President and Corporate Director,* HABRIDGE HOUSE, Inc.

Mr. Kasper managed the firm's transportation practice and was responsible for a wide array of projects involving domestic and international transportation issues affecting every mode of transportation. His clients included the U.S. Secretary of Transportation (assistance in preparing the National Transportation Policy Statement including analyses of issues affecting all transport modes) and the Office of the Secretary of Defense (analysis of the Civil Reserve Air Fleet Program).

1979-1983: UNITED STATES CIVIL AERONAUTICS BOARD

Director of International Aviation: Mr. Kasper served as Director of International Aviation, the Board's primary advisor and chief line officer for all matters involving international aviation. Mr. Kasper frequently represented the Board at sub-Cabinet meetings and on inter-agency working groups responsible for developing trade sanctions and other responses to international aviation disputes.

1976-1981: Faculty, HARVARD BUSINESS SCHOOL

While on the faculty of the Harvard Business School, Mr. Kasper focused on the impact of alternative forms of government regulation on the management and performance of business organizations and on the study of national economic policies and strategies. Mr. Kasper authored a number of case studies and articles on various aspects of the transportation and telecommunication industries.

While at Harvard, Mr. Kasper was also a member and active participant in the Harvard Regulatory Reform Project conducted under the auspices of the Kennedy School of Government. He also consulted with firms in the telecommunications and computer industries to help them anticipate and prepare for the impact of telecommunications deregulation on their businesses.

1971-1976: Faculty, UNIV. OF SOUTHERN CALIFORNIA SCHOOL OF BUSINESS ADMINISTRATION

While at USC, Mr. Kasper developed, administered and taught courses dealing with the control of business activities by means of direct government regulation, the enforcement of private contracts, and through the use of tort law. His research focused on the regulation of transportation, telecommunications industries and workplace safety. He also served as a member of the Faculty Senate.

EDUCATION:

Bachelor of Arts, Political Science, University of Kansas

Masters in Business Administration, University of Chicago

Juris Doctorate, University of Chicago

TESTIMONY SINCE SEPTEMBER 2006

In re: AMR, Corporation, *et al.*, Debtors.

Expert Declaration, deposition and trial testimony in regarding airline industry economics, finance and competition. The United States Bankruptcy Court for the Southern District of New York, Chapter 11, Case No. 11-15463 (SHL), 2012.

Air Transport Association of America, Inc. v. Export-Import Bank of the United States

Expert Declaration regarding impact of subsidized financing for foreign carriers on U.S. airline competitiveness and employment. United States District Court For the District of Columbia, Civil Action No. 11-cv-2024, November 2011.

Horizon Airlines vs. International Brotherhood of Teamsters, Local 1224

Expert testimony before Ira F. Jaffe, Independent Arbitrator, In the Matter of the Interest Arbitration Between International Brotherhood of Teamsters, Local 1224 and Horizon Air Industries, Inc. Seattle WA, September 2011.

United Technologies vs. Rolls Royce

Expert Report in the Matter of Certain Turbomachinery Blades, Engines and Components Thereof, United States International Trade Commission Investigation No. 337-TA-751, June 24, 2011.

Atlas Air Inc. and Polar Air Cargo, Inc. vs. International Brotherhood of Teamsters, Airline Division

Expert testimony before Richard Kasher, Independent Arbitrator, In the Matter of the Interest Arbitration Between Atlas Air Inc. and Polar Air Cargo, Inc. and the International Brotherhood of Teamsters, Airline Division. Washington, D.C., December 2010.

Delta/AirTran Baggage Fee Antitrust Litigation

Class Certification Expert reports and deposition testimony in Delta/AirTran Baggage Fee Antitrust Litigation, Civil Action File Number 1:09, md-2089-TCB, United States District Court, Northern District of Georgia, Atlanta Division, 2010-2011.

Allied Pilots Association vs. American Airlines, Inc.

Expert analysis and arbitration testimony regarding economics of international codesharing and alliances. Grievance No.P-47-08. Hill Presidential: Joint Business Agreement, June 2009.

Northwest Airlines, Inc., vs. Association of Flight Attendants, CWA.

Expert analysis and arbitration testimony regarding the value of certain scope clause changes to the Northwest-Air Line Pilots Association (ALPA) collective bargaining agreement, April 2009.

Midwest Airlines, Inc. vs. Air Line Pilots Association and Association of Flight Attendants, CWA.

Expert analysis and arbitration testimony regarding use of regional codeshare partners in U.S. airline industry, November 2008 and December 2009.

United Air Lines, Inc. vs. Lisa Stout, individually and the marital community comprised of Lisa and Ray C. Stout

Expert report and deposition testimony regarding potential economic damages resulting from termination of employment. United States District Court, Western District of Washington at Seattle, Civil Action No.CV07-3682-JCC. March 2009.

United Air Lines, Inc vs. Air Line Pilots Association

Expert report (with Darin N. Lee) and testimony regarding impact of pilot job actions. United States District Court, Northern District of Illinois, Eastern Division, September 2008.

Innovative Solutions and Support, Inc. vs. J2, Joseph Caesar, James Zachary, Zachary Technologies, Inc and Kollsman, Inc.

Expert report and testimony regarding damages arising from alleged misappropriation of intellectual property contained in aircraft components. United States District Court, Western District of Tennessee Western Division, Case No: 05-2665-MIP. July 2007.

Alaska Airlines, Inc., et al v. Los Angeles World Airports, et al

Expert analysis of economic claims arising in a dispute over rates and charges imposed on airport tenants by Los Angeles World Airports. U.S. DOT, Docket-OST-2007-27331, February 16, 2007.

City of Baton Rouge et al vs. American Home Assurance Company And J. Calderera & Company, Inc.

Expert analysis of claim for damages arising from delays in completion of an airport terminal project. January 2007. District 19th Judicial District Court, Number 493,788 Div: "D" State of Louisiana, January 2007.

Comments on Proposed Operating Limits at New York LaGuardia Airport

Written comments on proposed operating limits at LGA. FAA Docket No. 2006-25709, December 2006 and June 2008 (with Darin N. Lee).

Comments on Notice of Proposed Rulemaking Congestion Management for John F. Kennedy International Airport And Newark Liberty International Airport

Written comments (with Darin N. Lee) on proposed changes in operating limits and slot allocations at JFK and EWR Docket No. FAA-2008-0517, July 2008.

In Re Delta Air Lines, Inc. et al., Bankruptcy Litigation

Expert analysis and trial testimony regarding airline industry economics, finance and competition. The United States Bankruptcy Court for the Southern District of New York, Chapter 11 Case No. 05-17923 (PCB), 2005-2006.

In Re Northwest Airlines, et al., Bankruptcy Litigation

Expert analysis and trial testimony regarding airline industry economics, finance and competition. The United States Bankruptcy Court for the Southern District of New York, Chapter 11 Case No. 05-17930 (ALG), 2005-2006.

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- 1) *Deregulation and Globalization: Liberalizing International Trade in Air Services*, Ballinger Publishers, Cambridge, MA, 1988.
- 2) *The U.S. Regional Airline Industry to 1996: Markets, Competition, and the Demand for Aircraft*, The Economist Publications, London & New York, 1987.

**APPENDIX B: LIST OF DOCUMENTS AND INFORMATION SOURCES
CONSIDERED**

PUBLICLY AVAILABLE DATA AND DOCUMENTS

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24. "Comair Plans to Slash Fleet, Labor Costs," *Aviation Week*, September 2, 2010.
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32. "Distress Call: More Worries Arise for U.S. Regional Carriers," *Aviation Week & Space Technology*, November 21, 2011.
33. "Domestic giant Southwest sticks nose into international air", *USA Today*, May 23, 2012
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35. "Fare Restructuring in Cincinnati – Second Quarter 2005," Office of Aviation and International Affairs, Aviation Analysis, Domestic Aviation Competition Issue Brief Number 28.
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Regional Jet Aircraft over Next 23 Months,” Frontier Airlines Press Release, January 11, 2007.

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92. Pinnacle Airlines Corporation, Annual Report, year ending 2003.
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96. SkyWest Airlines, Form 10-K, year ending 2009.
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99. Spirit Airlines, Inc., Form 10-Q, first quarter 2012.
100. US Airways Group, Form 10-K, year ending 2011.

PINNACLE DOCUMENTS AND DATA

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102. 5.8.2012 All Contracts LRO Delta PNCL &L_Dataroom.CONFIDENTIAL.xlsx
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103. 6.15 120523 Data and Assumptions for ALPA.Confidential.xlsx (**Confidential**).
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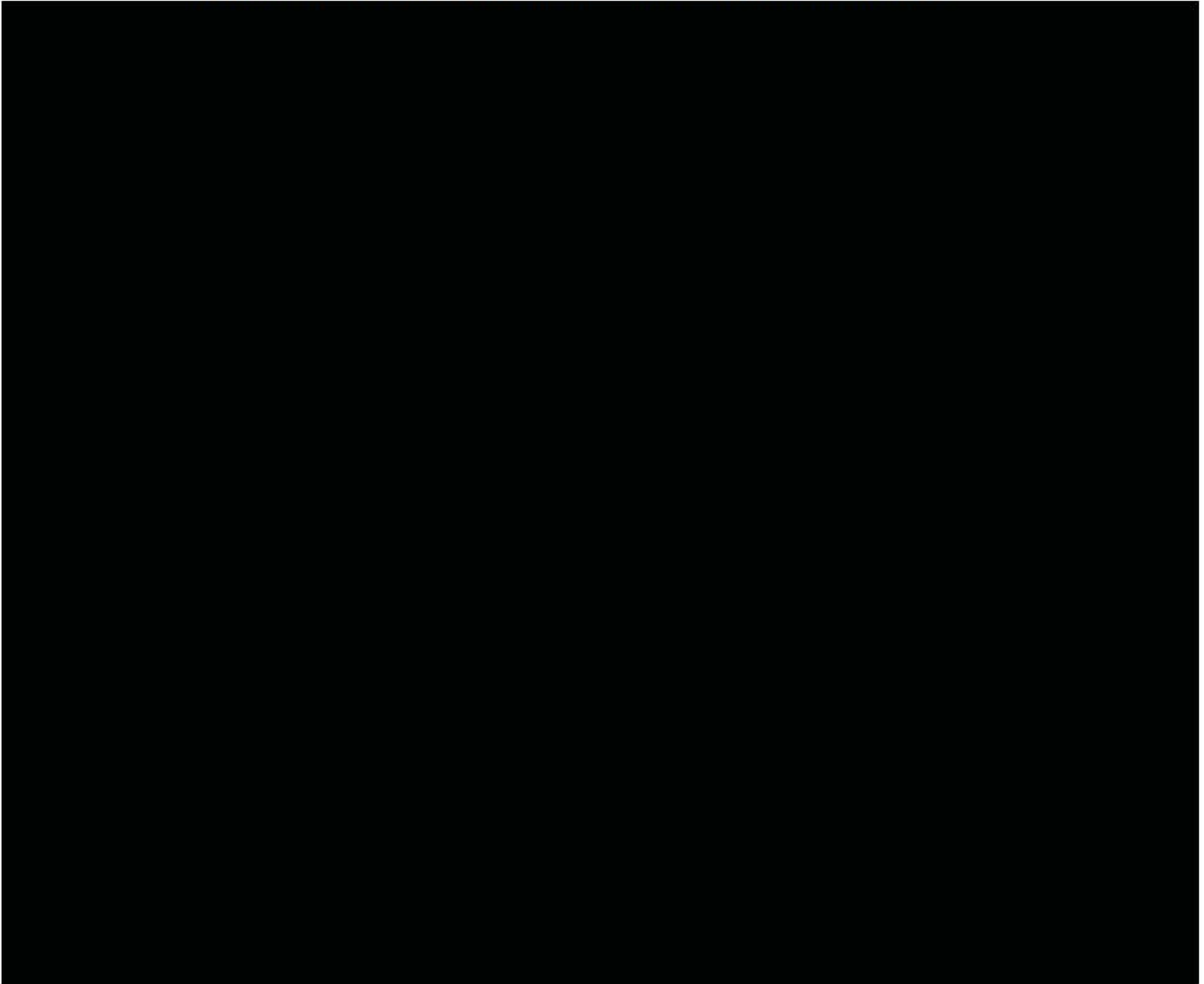
**APPENDIX C: INCREASE IN CRJ-900 SENIORITY AND AVERAGE HOURLY
PILOT WAGE AND WAGE-RELATED COSTS DUE TO REMOVAL OF 16
CRJ-900 AIRCRAFT**

90. As noted above, Pinnacle will cease to flying 16 CRJ-900 aircraft based in Atlanta during the first half of 2013.¹³² The removal of these aircraft will result in some junior CRJ-900 pilots moving down to CRJ-200 aircraft, thereby increasing the average seniority of remaining CRJ-900 pilots, resulting in higher wage and wage-related costs for its CRJ-900 operations.
91. To estimate the effect on seniority and average hourly pay, I estimated the number of pilots needed after the aircraft are removed. The pilot list was adjusted for the removal of the 16 CRJ-900s by removing pilots from the bottom of the CRJ-900 seniority list. For example, column 3 of Exhibit 34 shows the seniority distribution for Mesaba/Pinnacle CRJ-900 captains in February 2012. It is estimated that of the [REDACTED] captains as of February 2012, [REDACTED] would be required after the 16 aircraft were removed and the subsequent seniority distribution is shown in column 4.¹³³ The average seniority of a CRJ-900 captain increases from [REDACTED] years to [REDACTED] years as a result of the removal of 16 CRJ-900s. Using the proposed pay rates in the May 18th term sheet, the average hourly captains' wage rate goes from [REDACTED] to [REDACTED], an increase of [REDACTED]

¹³² See Footnote 87 above.

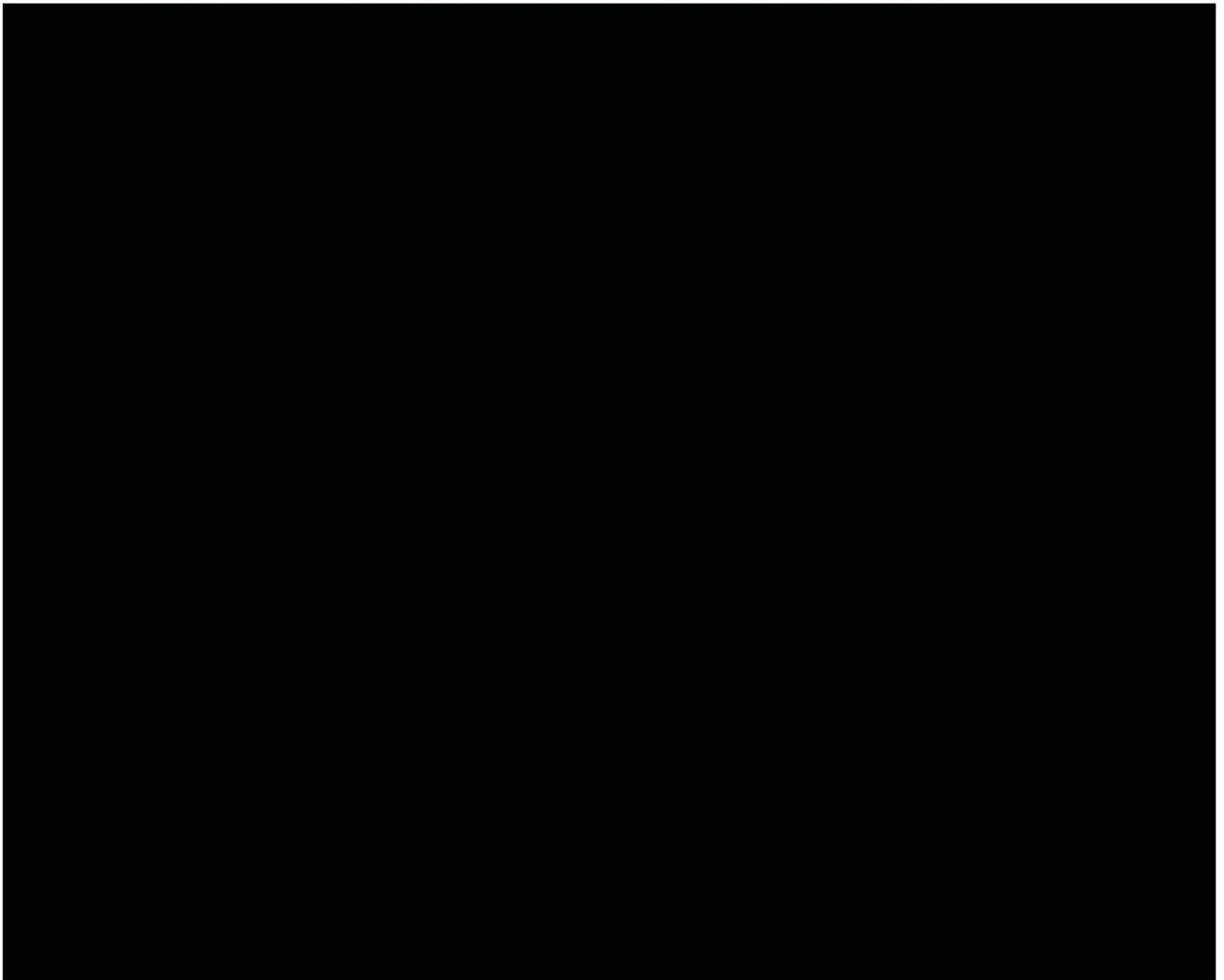
¹³³ See 6.44 120816 Buildup of PNCL cost disadvantage (for data room).xlsx

EXHIBIT 31: ESTIMATION OF CRJ-900 CAPTAINS SENIORITY



92. Exhibit 35 shows the same analysis for first officers, and indicates that removal of the 16 CRJ-900s increases CRJ-900 first officer seniority from ■ to ■ years increasing the average hourly wages by ■%.

EXHIBIT 32: ESTIMATION OF CRJ-900 FIRST OFFICERS SENIORITY

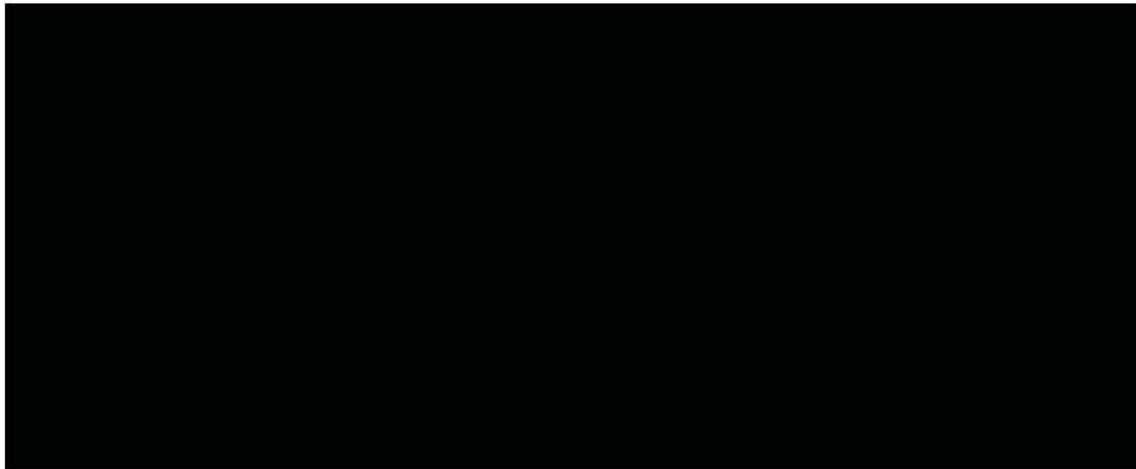


93. Exhibit 33 shows how the estimated [REDACTED] % increase in average captains' pay per hour and [REDACTED] % increase in average first officers' pay per hour translates into increases in pilot cost per pilot block hour. The first row shows Pinnacle CRJ-900 pilot cost per pilot block hour of \$174.99 from Form 41 (*see* Exhibit 29 above). This is then lowered by 18.3% to account for the initial proposed reductions.¹³⁴ This results in a pilot cost per pilot block hour of \$142.97 or a

¹³⁴ See 2.5 120518 - Pinnacle - Labor cost savings summary.pdf.

pilot cost per aircraft block hour (i.e., for two pilots) of \$285.94. This amount is allocated to captains and first officers in the same proportion as the weighted average pay in Exhibit 34 and Exhibit 35 above (e.g., █% for captains and █% for first officers) giving an estimated cost per block hour of \$█ for captains and █ for first officers. Since the increase in average pay rate would affect both wage and wage-related expenses (but not expenses unrelated to pay) I have estimated that approximately 87% of pilots costs are wage and wage-related,¹³⁵ resulting in wage and wage-related pay of \$█ and █ for captains and first officers, respectively. After applying the seniority driven increases in hourly pay of █% and █% to wage and wage-related pilot costs, the non-wage related pay is added back, resulting in captains' and first officers' cost per block hour of █ and █, respectively. Averaging these gives a final pilot cost per block hour of █, an increase of █.

EXHIBIT 33: CHANGE IN PILOT COSTS



¹³⁵ Based on analysis of 6.28 RJ900 Data.CONFIDENTIAL.xlsx.

**APPENDIX D: ESTIMATION OF PINNACLE FLIGHT ATTENDANT PAY GAP
VERSUS COMPASS AND GOJET**

94. To estimate Pinnacle's flight attendant cost gap versus Compass and GoJet, the current flight attendant distributions for Compass and GoJet were estimated based on the number of aircraft both carriers had in each year of their existence and assumptions on staffing ratios (i.e., the number of flight attendants needed per aircraft) and attrition (i.e., the number of flight attendants that leave each year).
95. Exhibit 34 shows the derivation of the estimated seniority and average pay rate for Compass. I assume that Compass requires 9.8 flight attendants per aircraft (i.e., approximately five crews of two flight attendants).¹³⁶ Compass began in 2007 with two aircraft, so their total number of flight attendants in 2007 is estimated to have been 20. In the second year, they flew (on average) 23.5 aircraft, which would require 231 flight attendants. Assuming that each year 20% of the flight attendants leave (distributed evenly across cohorts) there would be 16 flight attendants at year two remaining, and therefore, Compass would have had to hire 215 new flight attendants. Repeating the same calculation in each subsequent year leads to the 2012 estimated seniority distribution with an average seniority of 3.0 years. With their current pay rates, this implies an average hourly pay of [REDACTED].

¹³⁶ Source: 6.44 120816 Buildup of PNCL cost disadvantage (for data room).xlsx.

EXHIBIT 34: ESTIMATION OF COMPASS FLIGHT ATTENDANT SENIORITY

Number of Compass Flight Attendants							Rates
Seniority	2007	2008	2009	2010	2011	2012	
20	0	0	0	0	0	0	
19	0	0	0	0	0	0	
18	0	0	0	0	0	0	
17	0	0	0	0	0	0	
16	0	0	0	0	0	0	
15	0	0	0	0	0	0	
14	0	0	0	0	0	0	
13	0	0	0	0	0	0	
12	0	0	0	0	0	0	
11	0	0	0	0	0	0	
10	0	0	0	0	0	0	
9	0	0	0	0	0	0	
8	0	0	0	0	0	0	
7	0	0	0	0	0	0	
6	0	0	0	0	0	6	
5	0	0	0	0	8	88	
4	0	0	0	10	110	88	
3	0	0	13	138	110	44	
2	0	16	172	137	55	74	
1	20	215	171	68	93	112	
Total	20	231	356	353	375	412	

Number of Aircraft	2	23.5	36.25	36	38.25	42
Longevity	1.0	1.1	1.6	2.3	2.7	3.0
Weighted Average Hourly Pay						

Source: U.S. DOT Form 41, 120816 longevity benchmark analysis vfinal.xlsx.

96. Exhibit 35 repeats the same analysis for GoJet (using the same assumptions) and shows that the average seniority in 2012 is estimated to be 2.7 years with a weighted average hourly pay of [REDACTED].

EXHIBIT 35: ESTIMATION OF GoJET FLIGHT ATTENDANT SENIORITY

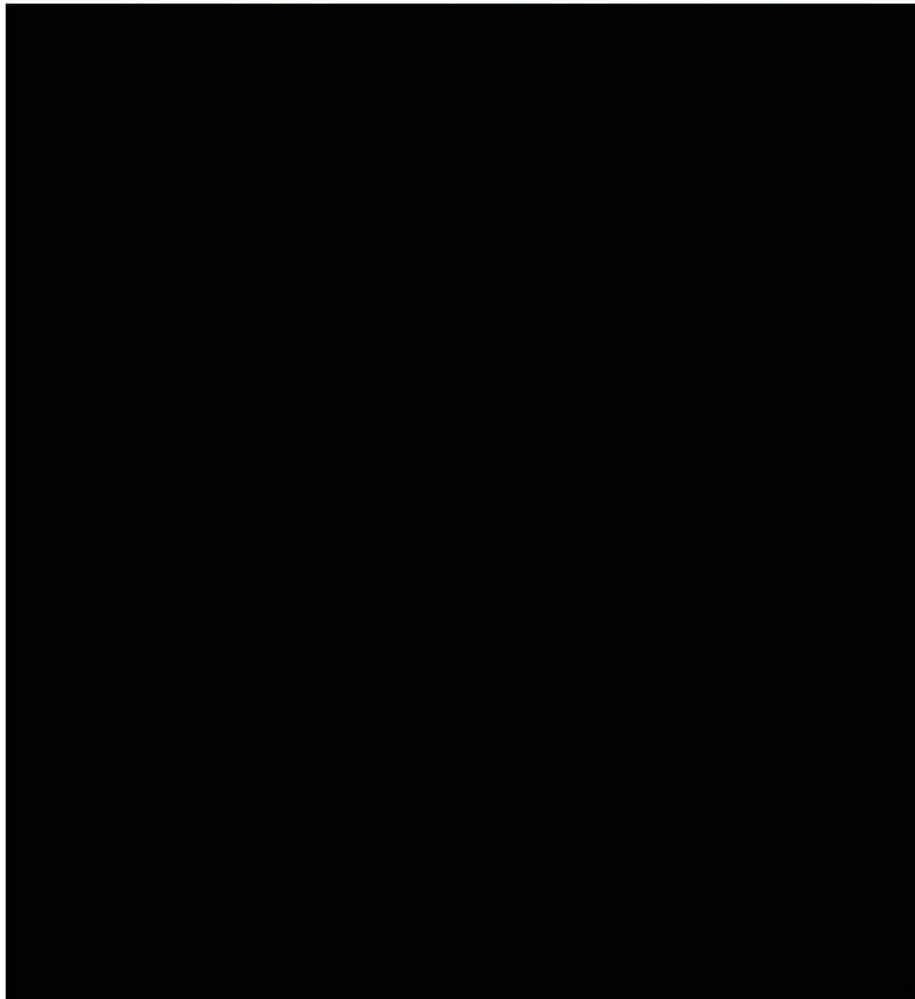
Number of GoJet Flight Attendants									Rates
Seniority	2005	2006	2007	2008	2009	2010	2011	2012	
20	0	0	0	0	0	0	0	0	
19	0	0	0	0	0	0	0	0	
18	0	0	0	0	0	0	0	0	
17	0	0	0	0	0	0	0	0	
16	0	0	0	0	0	0	0	0	
15	0	0	0	0	0	0	0	0	
14	0	0	0	0	0	0	0	0	
13	0	0	0	0	0	0	0	0	
12	0	0	0	0	0	0	0	0	
11	0	0	0	0	0	0	0	0	
10	0	0	0	0	0	0	0	0	
9	0	0	0	0	0	0	0	0	
8	0	0	0	0	0	0	0	2	
7	0	0	0	0	0	0	3	31	
6	0	0	0	0	0	3	39	15	
5	0	0	0	0	4	49	18	13	
4	0	0	0	5	61	23	17	41	
3	0	0	6	77	29	21	52	53	
2	0	8	96	36	26	65	66	43	
1	10	120	45	32	81	82	54	165	
Total	10	128	147	150	201	243	248	363	

Number of Aircraft	1	13	15	15.25	20.5	24.75	25.25	37
Longevity	1.0	1.1	1.7	2.4	2.4	2.6	3.0	2.7
Weighted Average Hourly Pay								

Source: U.S. DOT Form 41; Pinnacle.

97. The average hourly pay rate and seniority is calculated for Pinnacle based on the current seniority list and the May 8th proposed pay rates (*see* Exhibit 36).

EXHIBIT 36: PINNACLE FLIGHT ATTENDANT SENIORITY



Source: U.S. DOT Form 41; 6.44 120816 Buildup of PNCL cost disadvantage (for data room).xlsx; Pinnacle.

98. The next step is to calculate the estimated annual flight attendant crew cost for RJs requiring two flight attendants such as the CRJ-900. Column [A] of Exhibit 37 shows the average hourly pay for each of the carriers (derived above). This hourly rate is increased to account for wage-related benefits (the “burdening” ratio), which I assume to be 110% for all three carriers.¹³⁷ Likewise, I assumed that all three carriers fly their aircraft an average of 9.5 hours per day. Finally, because flight attendants are paid for more hours than the block hours they fly,

¹³⁷ See 6.44 120816 Buildup of PNCL cost disadvantage (for data room).xlsx.

the costs are increased by the paid hour-to-block hour ratio, which I assume to be 1.25).¹³⁸ Column [G] summarizes the estimated annual flight attendant cost per aircraft based on these calculations.

EXHIBIT 37: FLIGHT ATTENDANT ANNUAL COST PER AIRCRAFT

	[A]	[B]	[C] = [A] x [B]	[D]	[E]	[F]	[G] = [C] x [D] x [E] x [F] x 365		
	Average Seniority	Weighted Average Hourly Pay	Burdening Ratio	Weighted Average Pay and Benefits	Flight Attendants per Aircraft	Hours Aircraft Flown per Day	Paid to Block Ratio	Annual Flight Attendant Flying Cost per Aircraft	Difference from Pinnacle
Pinnacle	█	█	110%	█	2	9.5	1.25	█	
Compass	2.96	█	110%	█	2	9.5	1.25	█	█
GoJet	2.66	█	110%	█	2	9.5	1.25	█	█

Source: U.S. DOT Form 41; 6-44-120816 Buildup of PNCL cost disadvantage (for data room) .xlsx; Pinnacle

¹³⁸ Based on the average flight attendant being paid for approximately 75 hours, and, from Exhibit 28, flying approximately 60 block hours.